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SECURITIES AND EXCHANGE COMMISSION

PUBLIC ROUNDTABLE ON

GOVERNANCE AND CONFLICTS OF INTEREST

IN THE CLEARING AND LISTING OF SWAPS

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P R O C E E D I N G S

(9:00 a.m.)

MR. RADHAKRISHNAN: Good morning. My name is Ananda Radhakrishnan. I am the director of the Division of Clearing and Intermediary Oversight at the CFTC.

I am pleased to open the Joint CFTC-SEC Public Roundtable to discuss issues related to governance and conflicts of interest in the clearing and listing of swaps and security-based swaps. This discussion this morning is divided into two panels. The first concerns types of conflicts while the second concerns possible methods for mediating conflicts. We have what we hope is a comprehensive agenda that is designed to focus a discussion.

We have a distinguished group of panelists, both for Panel 1 and Panel 2, and I'd like to thank them for agreeing to participate.

I'd also like to thank the staff of the SEC and the CFTC for their hard work in planning this roundtable. This roundtable is only one

example of the close and collaborative relationship that the staff of the CFTC has developed with the staff of the SEC, and we hope that this will continue to flourish.

The Dodd-Frank Act for the first time brings over-the-counter derivatives under comprehensive regulation. It requires standardized derivatives to be traded on transparent trading platforms and to be cleared by robustly regulated central counterparties. This will greatly reduce the risk in our economy and will benefit the American public. Identifying and mitigating conflicts of interest that may impede such trading and clearing is crucial for such benefits to be achieved. Therefore, we look forward to hearing the thoughts and analyses of those on the panels. The roundtable should assist both the SEC and the CFTC in implementing the Dodd-Frank Act.

Now, for the record, I wish to state that all statements and opinions that may be expressed and all questions asked by CFTC staff

are those of CFTC staff and do not represent that views of any commissioner or the Commission, collectively. And before I invite my colleague, Robert Cook, some housekeeping items with respect to technology.

Everybody should know that the meeting is being recorded. The microphones that you have in front of you, press the button in front of you, and you'll see the red light. That means you can talk, speak directly into it. When you finish, please press the button again to turn off the microphone. And, finally, please refrain from putting any BlackBerry or cell phones on the table as they have been known to cause interference in the audio system.

And now it gives me great pleasure to invite my colleague, Robert Cook, to make opening remarks. Thank you.

MR. COOK: Thanks, Ananda. Good morning, I'm Robert Cook. I'm the director of the Division of Trading and Markets at the FCC, and it's my great pleasure to be here today with my

fellow staff members from the CFTC and the SEC.

I'd like to start by thanking the CFTC and its staff for hosting and organizing the event this morning, the first in a series of roundtable discussions concerning the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I'd also like to echo Ananda's comments about the very close working relationship we have between the two staffs and the great pleasure it gives me to be part of that, and I look forward to continuing to have a very productive and fruitful dialogue with them.

I would also like to extend our appreciation to the panelists this morning, who are with us to share their insights, advice, and recommendations. We're truly grateful for your participation in this roundtable and for your willingness to share your views with us. Your participation today will help us as we move forward in faithfully and fully implementing the provisions of the Dodd-Frank Act.

Just by way of housekeeping matters as

well, I will repeat the same disclaimer that Ananda just gave, that any opinions, views, questions from which opinions might be inferred or otherwise from the SEC staff reflect merely staff opinions and do not reflect the opinions of any of the Commission, of the SEC, the commissioners or any of our other colleagues on the staff of the Commission.

I would also like to point out that this is not the only opportunity for interested parties to have input on these important matters. Both of the agencies have open mailboxes into which anyone from the public can submit comments and supporting materials. And they will be read through by the staff, and we very much encourage people to take advantage of that. We really want to get broad input into not only the conflicts rulemaking that we were talking about today, but all the rulemakings related to the implementation of Dodd-Frank.

So with that I'll hand it back over to Ananda.

MR. RADHAKRISHNAN: Thanks, Robert. Before we start the panel, I'd like to go through the agenda. We have two panels. The first panel deals with types of conflicts and there are three discussion items. And I'm the designated timekeeper, so make sure that we stay on time. So between now and 9:45 we're going to talk about securities clearing agencies and derivatives clearing organizations, specifically topics relating to access to clearing, the determination of swaps are legible for clearing, and risk management.

9:45 to 10:15, Security-Based Swap Execution Facilities and Swap Execution Facilities. Again the issues will be access to trading, determination of swaps eligible for trading, and the potential for competition with respect to the same swap.

And then from 10:15 to 10:45, Designated Conflict Markets and National Securities Exchanges topics. That will be the listing of swaps and the comparison with conflicts of interest for swap

execution facilities and security-based swap execution facilities, similarities, and differences.

Then we go on at 10:45 to Panel 2, which concerns possible methods for remediating conflicts.

10:45 to 11:05, Ownership and Voting Limits. 11:05 to 11:25, Structural Governance Arrangements. Here the specific sub-topics will be independent or public director requirements for board and board committees, consideration of market participant views with respect to DCOs and designated contract markets, the fair representation requirement in the Securities Exchange Act, and other governance matters such as transparency.

11:25 to 11:45, Substantive Requirements, Membership Standards, Impartial Access Requirements.

And 11:45 to 12:00, Appropriateness of Applying the Same Methods to Each Type of Entity. And we hope to conclude the roundtable at 12

o'clock. You will notice there is no room for breaks, so -- and that's because of the time we have.

So before we start Panel 1, I would like to invite the panelists to, you know, introduce themselves and let us know where they're from. So we'll start with Jonathan Short.

MR. SHORT: Jonathan Short, Intercontinental Exchange.

MR. NAVIN: Bill Navin, the Options Clearing Corporation.

MR. OLESKY: Lee Olesky, Tradeweb.

MR. HILL: James Hill, Morgan Stanley, on behalf of the Securities Industry and Financial Markets Association.

MR. KASTNER: Jason Kastner, vice chairman, Swaps and Derivatives Market Association.

MS. SLAVKIN: Heather Slavkin, AFL-CIO.

MR. BERNARDO: Shawn Bernardo, Tullett Prebon, on behalf of the Wholesale Market Brokers Association.

MR. DeLEON: Bill DeLeon, Kinko.

MR. RADHAKRISHNAN: Go ahead.

MR. DUFFIE: And Darrell Duffie of Stanford University.

MR. KROSZNER: And Randy Kroszner, University of Chicago, Booth School of Business.

MR. SHORT: I would like to echo my thanks to all the panelists for participating here today.

I would start off by asking just basically what do you see as being the primary sources of conflicts within clearing AGs and DCOs, and specifically those that clear swaps and securities-based swaps, and I open this question up to all the panelists.

MR. KASTNER: Again, Jason Kastner from the SDMA. I think one of the fundamental issues which is well- addressed in the law in Section 725 is the issue of fair and open access. The SDMA is a strong proponent of central clearing. We believe that anything that can be cleared should be cleared. We also believe that economic

interests should be set aside to mitigate systemic risk and protect the American public against further financial calamity.

In order to do that, it is more efficient to bring transparency and open access and to allow more participants into the market to diversify risk. We must remember that the essential point of the Dodd-Frank Act is to address the issue of too big to fail and too interconnected to fail. And by permitting unfettered access to clearing and bringing in more participants, we address those risks and help protect the American public.

MR. SHORT: I would like to share ICE's perspective on this issue. Certainly open access is an important part of the Dodd-Frank Act, but it is certainly not the primary driver of the Act. I think one of the biggest conflicts that has to be addressed here is the conflict between open access and proper risk management of the clearinghouse. And one of the things that I think has to happen is that people need to step back and consider that

clearinghouses are going to be the ultimate repositories for all of the systemic risk that was previously dispersed throughout the market.

And one of the things that I think needs to be carefully considered is the clearinghouses' obligation to manage that risk and perhaps the limitations that have to be placed on SEFs or other market participants in their access to the clearinghouse. I'm not saying that that eviscerates open access -- it certainly doesn't -- but I think there's the balance there, and the members of the clearinghouse are ultimately the parties that are underwriting this risk and responsible for it.

MR. HILL: I wonder if I could just add to that. This is Jim Hill from Morgan Stanley. I think there's two parts to access: The first is we certainly agree that every customer who is transacting -- every individual and customer who's transacting in OTC derivatives should have access to a clearinghouse, should be able to clear their trades through a clearinghouse. That goes without

saying that's required by the law. I think everyone in this room probably agrees that that's clearly the case.

But the second piece of this is who should be a clearing member. And that's where we get into the risk management issues of the systemically important clearinghouses, and the key thing that people need to think about is when once all these OTC derivatives are concentrated in the clearinghouse, what is the purpose of the clearinghouse? The purpose is if one of the clearing members were to default and become insolvent, the risk needs to be absorbed by the other clearing members.

And the way that risk is absorbed is twofold. The first is the surviving clearing members put capital into the clearinghouse, so they have to have a sufficient capital base so that they can put capital into the clearinghouse in a time of crisis.

And two, and perhaps even more importantly, they have to be able to absorb the

positions, the risk positions of the defaulting member. So, for example, if an entity like Lehman Brothers is a clearing member in the clearinghouse and it defaults, in order for the clearinghouse to remain flat risk and itself not become insolvent the risk of the OTC derivatives, the economic risk, needs to be replaced. And the way it gets replaced is the surviving clearing members enter into transactions, OTC derivatives, with the clearinghouse to replace that market risk.

So not only do you need to have clearing members who have enough capital, you know, to recapitalize the clearinghouse if a member defaults, but they have to be able to keep the clearinghouse flat from an economic risk perspective, which means they have to be able to trade very large amounts of very highly complex illiquid OTC derivatives. And if they can't do that, by introducing them as a clearing member into the clearinghouse, you actually increase risk in the clearinghouse because at a time when a member is defaulting, the clearinghouse won't be

able to absorb the losses.

And that is critical. And if we don't get that right, we end up with clearinghouses that, where all this risk is concentrated, that are inappropriately risk- managed.

MR. OLESKY: Lee Olesky from Tradeweb. I guess I have a slightly different perspective I'd like to raise which has to do with a potential conflict when a clearinghouse is both a clearinghouse and also an exchange venue. As we see in the futures markets and other markets, if you have both execution and clearing, we think it's very important for there to be a competitive environment among execution venues. And in order to have that competitive environment among execution venues, that requires really equal and fair access from any execution venue into a clearing corp.

So it's a slightly different slant on what everyone's been saying to this point, but from an execution venue standpoint we think it's really critical for there to be a competitive

environment so that we can access the central counterparties.

MR. NAVIN: This is Bill Navin from OCC.

MR. DeLEON: Bill DeLeon from Kinko. I think, you know, there definitely is some very good points here, and I'd like to first bring up the issue (inaudible).

MS. SCHNABEL: I'm sorry, Bill, you're breaking up a little bit. Can you -- we're having some echoes. Can you make sure that there are no BlackBerrys where you are?

(Interruption; speakerphone malfunction)

MS. SCHNABEL: Heather, would you like to say something while we're waiting for (inaudible)?

MS. SLAVKIN: Sure. What I was starting to say earlier is that I think -- I'm sorry, can you hear me now?

What I was starting to say earlier is that I think in addition to the access question there's a concern generally about who owns and

controls the clearinghouses. If there's an interest among the people who own the clearinghouse, or a conflict of interest that would create incentives for them to also favor, you know, now allowing certain types of swaps to clear because they may be more profitable for the institution generally if they remain over the counter, then that can create perverse incentives to maintain the over-the-counter, nontransparent, systemically risky markets when the goal needs to be to prevent those conflicts of interest to ensure that anything that can be cleared does, in fact, clear.

MR. HILL: I wonder if I could respond to that. I think there's a bit of a misconception that somehow clearing makes trades less profitable. That's clearly not the case. In fact, I think most of the large systemically important participants in this market prefer clearing. And I think that's not just a statement; there is significant anecdotal evidence to support that perhaps the most important of

which is LCH.

LCH is one of the main clearinghouses for interest rate derivatives. It was founded, at least with respect to interest rate swaps, over I think it was nine or ten years ago. They're currently clearing $230 trillion of interest rate swaps. There was no law that required LCH, you know, for people to use LCH for clearing. There was never regulatory encouragement or mandate of any sort; it was formed by consortium of dealers to mitigate the counterparty risk. And it was done because from an economic perspective it was deemed to be prudent as well as risk reducing, and to suggest, then, somehow that people, that dealers purposefully created LCH 10 years ago to reduce their own profits doesn't really make sense. It was reduced to -- it was introduced to reduce risk.

And so, and as I said, you know, it's clearing currently $230 trillion of interest rate swaps, so it's hard to imagine why that would have happened if it actually reduced profits.

MR. DUFFIE: This is Darrell. Can I follow up on that, please?

MR. HILL: Please.

MR. DUFFIE: I agree with the idea that incentives are already aligned for a large amount of clearing. And as we attempt to get more counterparty exposures cleared, the issue arises of conflicts over what types of financial products must be cleared. The interest rate swaps is a good example of where regulatory pressure is not needed. As we move into additional products or more types of interest rate products, there are two approaches. One that's been suggested for Europe is for regulators to define what products will be standardized and cleared.

Another approach which I would advocate in order to reduce conflicts of interest and maintain the incentives that were just described is to increase the pressure for more clearing in general and allow the market participants to decide what particular products to clear. That's important because there's, if regulators should

make a mistake in their best efforts and define products for clearing that are not appropriate, first of all not enough clearing will occur, and, secondly, there will be some spurious customization of products that's designed to avoid the clearing of products that are not economical for markets to clear.

So I would advocate to use the capital requirements and collateral requirements to encourage more clearing rather than defining what specific products must be cleared.

MR. BERNARDO: Shawn Bernardo on behalf of the Wholesale Markets Association. I'd like to echo what Lee Olesky said, which is that we've seen entities or exchanges that have both execution and clearing, that it's not just a concern, but we've actual experience where you don't have fair and open access to the clearing and in the space that we're in, which is the execution of SEFs, if we don't have fair and open access to that clearing, it's a concern and it creates an issue for us moving forward.

MR. NAVIN: Bill Navin from OCC. Our model is one that does provide equal access from execution venues to the clearinghouse. While our stock is owned by Exchanges, we're controlled by the Street. Nine of our 16 directors are drawn from our clearing members, and over the last nearly 40 years we found that that's been a successful model.

I think it's important that, while there are certainly conflicts of interest that need to be taken into account, at the end of the day, effectively the capital of the clearinghouse is supplied by the membership, and the risk is borne out by the membership. And, therefore, it seems to us only fair that the membership should have an active role in determining how that risk gets managed.

MR. KASTNER: Jason Kastner again from the SDMA. I'd like to opine, if I may, on something that Jim Hill discussed with regards to the LCH. The LCH is a closed system. It requires that one have not only $5 billion of net capital

but $1 trillion if swaps already cleared.

Now, how does one join a clearinghouse if they require that you already have cleared $1 trillion of swaps? So the idea is again to bring more members, qualified members, well-capitalized members. But allow me to take an example of a very large clearing bank that clears $21 trillion of treasuries who is not allowed to become a clearing member of the LCH, one of our member firms.

Now, if we're going to be really clever about keeping people out of the system, the system is not going to work effectively. We're going to have the same OTC style, bilateral, closed, untransparent, opaque, risky system. And what we need to do is allow more entrants to diversify risk, address too big to fail and too interconnected to fail.

Secondly, I'd like to also say that it's not only about membership of a clearinghouse; it's about access to clearing services as a sort of introducing broker. So one of the other tenets of

the LCH is that one must, to be a party to a trade, one must be a clearing member of the LCH. And what we would support at the SDMA is a system whereby a member firm of the SDMA could use an LCH member firm as their sort of SCM, Swap Clearing Member, but actually take the execution risk, because there's a difference here between execution and clearing. And by time, inexorably, we're not addressing the issue of systemic risk.

MS. SCHNABEL: I have a quick question. I think one of the key issues that we've identified so far is the balance between open access and risk management, and to play off what Jason has just said about LCH and the requirements to become a clearing member such as $5 billion in capital and $1 trillion in transactions cleared, I was wondering, I guess, how is the balance struck currently between open access and risk management? Because I was wondering if anybody can have a perspective on how these requirements came about. I mean, why would $5 billion be necessary for risk management, or $1 trillion in transactions

cleared?

MR. HILL: I don't want to speak to any specific clearinghouse because I'm not sort of intimately familiar with any of the very detailed rules of each of the clearinghouses. But, I mean, as -- again, as a general rule, the clearing member needs to be able to absorb losses, a default by another clearing member, number one; and, number two, they need to be able to absorb the economic transaction risk in the portfolio of a defaulting member.

And so the way these clearinghouses set up their risk, you know, their admission or their membership criteria, is both of those things. So, A, they have to have a capital base sufficient to absorb losses and add in more capital to the clearinghouse if a member defaults. And B, they have to be able to in a situation where a clearing member has defaulted, which is probably the time of most economic stress, you know, in the economy, be able to take down the economic transaction risk of the swaps that were otherwise, the defaulting

member was otherwise a party to, those trades need to be allocated among the surviving clearing members.

And so the way these clearinghouses developed their criteria is they look at both of those prongs and they set thresholds to make sure that the members who are admitted can do those things. Because, remember, if you admit a member who can't do both of those things, then what happens is the clearinghouse will have insufficient capital in a situation where a member has defaulted, which is the time of the highest economic stress.

And so I mean perhaps, you know, a panel of the sort of risk managers of each of the major clearinghouses would be able to address that more specifically. But I think ultimately that's the framework on which they make decisions.

MR. RADHAKRISHNAN: Now, I know Randy Kroszner was trying to make a point earlier on, and it's audio issues.

Randy, can you hear us, and would you

like to make your point again?

MR. KROSZNER: I'm having difficulty hearing you, and so I apologize on that. Can you hear me?

MR. RADHAKRISHNAN: Yes, we can. Thank you.

MR. KROSZNER: Okay, great. Well, first I wanted to underscore what Darrell Duffie had said. I think that in terms of thinking about the determination of what's possibly eligible for clearing, we want to think about giving strong incentives through cap requirements, collateral requirements, but not necessarily mandating each individual -- contracting each individual product.

On the -- with the conflict of interest that you're talking about of being really getting to the heart of the issues that clearinghouses have been struggling with since they started to function as the guarantors of the contracts back in the late 19th century of getting the balance right between having access -- well, a combination of having access and having clearing members,

making sure that there are enough members, making sure there's enough trading and drawing things off the Exchange, but also ensuring that those members have the wherewithal to withstand the shocks to make the clearinghouse something that will reduce system risk, reduce interconnectedness rather than increase it.

And so I think these are exactly the very questions to be focusing on. Unfortunately, I couldn't hear a little bit of some of the specifics, so is there something in particularly you wanted me to comment on?

MR. RADHAKRISHNAN: No. One of the questions that was asked -- I don't know if you heard it -- was how do you find the balance between open access, fair access, and the desire for the risk management considerations: One, are decisions being made purely on risk management reasons and not, you know, anti-competitive or pro-competitive reasons? So how do you find the balance?

And one of the issues is, if you have a clearinghouse,

if I understand the discussion, if you have a clearinghouse that's dominated by a group of people -- I won't tell you who they are, but dominated by a group of people -- does that achieve the objective of fair and open access, or -- well, I guess the question is which should prevail? Ideally, both should prevail, but, you know, that you avoid conflict of interest but at the same time you make sure that all decisions are being made by the clearinghouse according to its risk management.

So if you care to share your thoughts with us on that, we'd appreciate it.

MR. KROSZNER: The law is very clear on what should prevail. It is rife within the law open access, fair, open, unfettered access, transparency. Risk management is better done in a default scenario if there are more members participating in an auction. And to say that an SDMA member firm that that clears $21 trillion of treasuries is somehow ineligible or unqualified to be a member of whatever clearinghouse is not addressing the issues properly.

And I would also like to point out Section 731 on page 342 of the Dodd-Frank Act which discusses this issue in a different way in regards to conflicts of interest right after Risk Management Procedures. It requires that banks establish structural and institutional safeguards and supervisory barriers and informational partitions between those who trade and those who provide clearing services.

So this is what we call in the SDMAs "the Chinese Wall provision." This is a very good provision because it goes directly to this issue of the conflict between trading and clearing. Because, currently, annually, there's estimated to be about 3- to $500 million made clearing, and there are between 40- and $60 billion being made trading. So this discussion of clearing and access to clearing is really just a proxy about access to trading, because that's where the revenues are. And the law is clear: Open access is the fundamental principle.

MR. RADHAKRISHNAN: And keep in mind if

you have a --

MR. DeLEON: This is Bill DeLeon, can you hear me?

MR. RADHAKRISHNAN: Yes. Yes, yes.

SPEAKER: Say, can you let Bill speak first, just because he was cut off earlier?

MR. DeLEON: Thank you very much. I find all this very interesting and there's some very good points here. In terms of, you know, (inaudible) to you and sort of concerns in general, I think it's important to separate clearing and access to clearing and what it represents in terms of (inaudible) risk.

Our view has been that clearing should be viewed as a utility where all members who use it have access to clear as well as to reduce systemic risk. And in order to reduce systemic risk, the member or firms who are supporting the Exchange or the clearing mechanisms need to be able to have sufficient capital. And it's important to note that sufficient capital to support is not -- come out of this with clearing

trade. It means actual capital is being supported. And whatever, you know, that view is the important differentiation because the mechanism where the trades are cleared has to be sufficiently strong and risk managed such that when you look at the members backing the Exchange, you're comfortable that both the member you're using for clearing as well as the overall clearing mechanism have sufficient capital to withstand a default by either a member or by a user of it.

So this is the important thing, is we view it as a utility function with correct risk management need. Who becomes a member should be a function of being able to provide the capital and support a member default because, ultimately, there is still commingled counterparty risk going on. And that is the important differentiation, you know. I, personally, wouldn't want to see, you know, anyone on this as a personal clearing member because I don't think anyone personally has enough capital to go in. But their firm, it's a question of how much capital they have when they

go in to support. There shouldn't be a club or a group, it's the utility, so I think that's important.

And then to the clearing and the trading execution, I think that's a very important thing, And I know that one of the later panels is going to talk about transparency and that information. But I think it's very important to separate the two things of clearing versus trade execution. What's the most important thing from our standpoint is that the trades get done, and once they're done that they'd be able to be cleared. That is how you mitigate risk is getting the trades turned into a TCP where there is risk management and there is sharing and margining, and it's been moved into a utility function as opposed to the opaque bilateral agreement whereby no one -- you know, only regulators can sort of figure out what's going in after the fact.

So those are sort of our big things. And I think that the risk management and ability of the Exchange to -- or the CCP to handle and

have members who can support the capital is the important thing.

MR. RADHAKRISHNAN: Shawn, you have a response?

MR. BERNARDO: I just wanted to point out again that if you have a clearing firm that charges fees for that clearing and then you have that same clearing firm has an execution venue that competes in the interdeal broker space, which is what we do, or as which is we create and we operate fair open access to our markets, it's transparent, and we charge a fee for what we do, that clearing firm cam who's also executing or allowing people to execute on their trading venue, not charge a commission. Basically, which you would not create a competitive or force a competitive atmosphere with what we're doing, and at some point in the future turn that commission back on for the execution.

So you can execute now on our platforms and compete, whereas a clearing firm can turn around and say, okay, we're not going to charge

for execution, we're just going to charge for clearing. So that open access is, it's just not there. It's --

MR. RADHAKRISHNAN: It doesn't mean --

MR. BERNARDO: A competitive and fair environment.

MR. WORKIE: I'm sorry, Dodd-Frank asks us to think about restrictions with respect to swap participants, major swap participants, bank holding companies and nonbank financial institutions, and when we're thinking about conflicts and potential restrictions, how should we think about them, either collectively within that group, or individually within those subgroups?

And just as a follow-up, does it make a difference if there are actually numbers of the clearing agency or DCO, or not when we think about these conflicts? And I imagine it would, but just I'd like some opinions on that.

MR. KASTNER: Well, I would refer you to Section 726 where it's sort of -- I call it Lynch

Light. You know, it was the Lynch amendment that now the Commission is to take under consideration certain ownership and control restrictions in DCOs. And I would say that the SDMA strongly supports restrictions on ownership and restrictions on control in DCOs, and the reason why is because if you have a club which is closed which controls not only what goes into the clearinghouse but who can become a member of it, it doesn't address the issues of too big to fail and too interconnected to fail.

So I would strongly suggest and highly recommend that well the Commission considers the implementation over the next 180 days of Section 726, that they do move forward and impose restrictions because, if they're not, there is a real risk that we're going to end up right back where we started again.

MS. GREGORY: I have a question. What types of conflicts -- oh, I'm sorry. Okay.

What types of conflicts of interest have arisen, or made potentially arise, in the

operation of a DCO with respect to determining which swaps are eligible for clearing?

MS. SCHNABEL: I believe that Heather spoke a little bit about that, but we would like to, you know, if you could just expound.

MS. SLAVKIN: I think that there's the risk that anything that could be made to appear to be something that is a bilaterally contract, you could have the spurious customization issues, if there's the opportunity to get additional profits within the big dealer banks, and those same dealer banks are running and controlling the clearinghouses, then, you know, the potential for spurious customization becomes a real issue and becomes a possibility.

MS. GREGORY: So that's --

MS. SCHNABEL: Sorry. Multiple times, I think I've heard concerns raised about the potential tying of execution and clearing. And I guess one concern that I've heard and maybe somebody can address it or speak more to it, is that with respect to clearing, I mean, the

clearinghouses would determine what swaps would be cleared and then, because of Dodd-Frank, the clearinghouse -- I mean the swaps that would be determined could be cleared, maybe listed on a SEF or a DCO.

And so it seems as if, perhaps, the circumstances surrounding clearing now may be slightly different than what have previously happened when LCH was first formed, for instance by the interdealer banks, and I was wondering if somebody can speak more to perhaps the shifted circumstances between then and now and what the incentives and what the conflicts of interest are for eligibility of clearing.

MR. HILL: Yeah, we -- it is our view that -- and I think Dodd-Frank requires this -- that clearinghouses be agnostic as to where they accept trades from, so clearinghouses should be open to any SEF. You know, we believe there will be multiple SEFs in the marketplace from, you know, for multiple products, and the clearinghouses should accept trades from multiple

SEFs which is consistent with the statute's goal of increasing clearing. And we also believe that SEFs should be clearing agnostic as well, meaning that SEF should feed in, you know, should be allowed to -- should be set up so as to allow the people using the SEF to choose which clearinghouse they want to go to.

So that clearinghouses should be agnostic and the SEFs, themselves, should be agnostic. That will, without question, ensure that the maximum amount of clearing that can occur will occur.

Going back to the point about who should decide what gets cleared, I want to emphasize that. I don't think the assumption that somehow clearing hurts profits is correct. I just don't think that's correct, and I haven't really heard any explanation as to why people think that. But, more importantly, again the members of the clearinghouse -- and we believe anybody who has the capital and the expertise to evaluation risk should be allowed to be a member, so we share that

view with, you know, some of the other members here.

But in terms of whether or not those clearing members should have a say in what gets cleared, the key I think for people to remember is that the clearing members themselves are the ones who capitalize the clearinghouse.

So with respect to all the clearinghouses that are out there for OTC derivatives, the clearing members have the overwhelming preponderance of capital in the entity. So, for example, XYZ clearinghouse, the clearing members may have put in $5 billion. The clearinghouse itself probably has about, you know, 20- to $50 million. So the overwhelming preponderance of capital in the clearinghouse is put up by the clearing members.

In evaluating what trades should be cleared, there's a balance that needs to be struck between the goal of increasing clearing, obviously, but, B, you don't want to put trades in the clearinghouse that can't be appropriately

risk-managed. So if you put trades in the clearinghouse that are illiquid and can't be valued properly, what will happen is when a clearing member defaults, there will be insufficient collateral with respect to that trade because it wasn't properly valued in the clearinghouse, and the surviving clearing members will be stressed from an economic perspective in taking positions the value of which cannot be readily ascertained.

So it's critical that only trades that can be appropriately risk-managed be put into the clearinghouse. And I think what you'll see is that most of the clearinghouses look to their clearing members to help them valuate which trades are appropriate from a clearing perspective, and that is completely consistent with the economic incentives because the clearing members are the ones who have the overwhelming preponderance of the capital in the clearinghouse. So it's their capital that's at risk. They should certainly have a say in helping the clearinghouse evaluate

which trades are acceptable for clearing and which trades are too risky or can't be valued, or are too illiquid or not standardized and, therefore, shouldn't be cleared.

MS. SCHNABEL: James, I have a quick question. When you say that it's the capital of the clearing members that are at risk, do you make a differentiation between margin and default fund?

MR. HILL: I'm speaking of the default fund when I say that.

MS. SCHNABEL: Okay, so margin is still the first line of defense, and that, you know, can be provided by customers as well?

MR. HILL: Correct. But when, in a situation where a clearing member is defaulting and markets are illiquid, if the margin is insufficient, then you look to the default fund to make sure the clearinghouse stays solvent.

MS. SCHNABEL: Jonathan and Bill, sorry, just a quick question. I mean from your experience in clearing, how many times have a default -- or has a default caused access to the

default fund, do you know?

MR. OLESKY: In our case, once back in 1987, and it was for a relatively trivial amount but it's something that you always have to be concerned about. And when you're talking -- we clear Exchange-traded products that are relatively liquid. I think when you start talking about over-the-counter products that can be complex and relatively illiquid, then you have to worry more about whether your margining system properly values them, and you have to be more concerned, I think, that you may need to have access at some point to your default fund.

And I second Mr. Hill's comments. I think that it's very important that the people who bear the risk and supply the capital should have a substantial voice in how that risk gets managed, and that includes what contracts are accepted for clearing.

MR. KASTNER: May I please, upon -- first of all, allow me to address something that Jim said. He keeps saying that, you know, there's

no money to be lost here, that clearing doesn't -- you know, there's no economic disincentive to preclude membership or keep things out of the clearinghouse, and again it's not about clearing; it's about execution. If you look at the BIS, 96 percent of the swap market is executed by the largest 10 banks. I think they call that an oligopoly. And the notion is if you introduce more competition into that 40 to 60 billion dollars which are at risk or being earned by execution, that's where the pushing and shoving begins. It's not about clearing per se; it's about competition for execution in interest rate swaps and CDS.

And allow me to make one other point. The problem with the clearinghouse is not when your smallest clearing member fails. The problem with the clearinghouse is when your highly interconnected, large, same guys are in the room and the top three of them go. That's when you have a problem with the clearinghouse. So, the notion somehow that you should restrict

arbitrarily membership to a clearinghouse such that you have more connected, larger, systemically important institutions who are highly correlated is patently wrong.

And I would also say, in specific response to the question before about a specific example, single-name CDS is a good example about how something that could be cleared and should be cleared could be viewed in an overly complex way such that somehow it would be precluded, and I think one of the main reasons that we passed the Dodd-Frank Act was to deal with risk in the CDS market.

MR. HILL: Okay --

MR. KASTNER: And I'll conclude.

MR. HILL: Can I just address -- we have started clearing single-name CDS, and I think highlighting single- name CDS might be a useful example for thinking about what can and can't be cleared. Looking at it simplistically, we should say, well, single-name CDS is standardized. It's all the same, so we should clear all single-name

CDS. And this is the issue we struggle with from a risk-management perspective. Single-name CDS on a very liquid U.S. Corporation that trades, you know, in the hundreds of millions every day -- true, that can be cleared, and it is starting to be cleared, because it can be valued by multiple market participants. Single-name CDS on a highly illiquid Latin American sovereign, which is only traded by two entities and only trades maybe once a month in $10 million clips -- they're both single-name default swaps; they're both completely standardized; one is extremely liquid and easy to value; one is completely illiquid and extremely difficult to value. The one that's liquid and easy to value should be cleared. The one's that's illiquid and can't be valued or very difficult to value should not be cleared. They're both single name CDS.

And so I think using -- you know, the point of single-name CDS highlights the risk-management issue here. It's easy for someone to say, who doesn't trade the product, single-name

CDS should be cleared; it's the same; it's all standard; let's clear it. You have to understand the risk of each individual contract, be able to value it, be able to trade it, and be able to set margin levels for it to decide whether it can be cleared. And that's critical. And if we don't get this right, we're centralizing all this risk in the clearinghouses. They will become the next too big to fail, and we don't want to do that. These have to be risk-managed correctly, and you need clearing members who understand the risk.

So we, again, are for complete open access to clearing membership in any clearinghouse as long as you have the capital to support it and as long as you have the risk-management tools to evaluate the risk of the products that are being cleared.

With that, we are absolutely for that kind of open access. From our perspective, the more clearing members that are in a clearinghouse who understand the risk who want to neutralize the risk, that is better for us. That takes risk away

from us.

MR. RADHAKRISHNAN: Okay, we've got to go on to the next topic, so I don't mean to cut off the discussion, but we've got an aggressive time schedule, so we want to make sure that all the topics get discussed. But people are free to send us their comments in writing, and I urge you to do so and, you know, I think if you look at the Federal Register at least, it will tell you how you can send it in writing, but please do so.

So, now we're going to go on to swap execution facilities, both security-based and non-security-based -- and Cody.

MR. ALVAREZ: This is a non-dimension. We're going to discuss swap execution facilities, and specifically we'd like to again speak about the conflicts of interest related to two points: Permitting access and determining which swaps are eligible for trading on the swap execution facility.

MS. SCHNABEL: And I think we talked a little about this previously. We're interested in

hearing more about vertical integration.

MS. SEIDEL: And also I would sort of, in this discussion as well, when you're sort of talking about conflicts of interest in the SEF or the security-based SEF space, in light of the structure of the Dodd-Frank Act where if a product is cleared then it is traded to sort of speaking of potential conflicts in light of the structure put in place by the Act.

MS. SCHNABEL: We're going to go down the line if no one volunteers.

MR. KASTNER: I'll take the ball for a second with the SEFs.

The same principles that apply to DCOs in terms of open access -- also if you carefully apply to SEFs, anybody who is able to get a clearing account at a qualified swap clearing member or FCM to use the, you know, futures analog, anybody that wants to trade on a SEF, the SEF should not have any barriers to entry. So, in other words, just like the futures markets, if you've got enough money in your margin account to

go along with wheat because you have an opinion about the Russian wheat harvest, similarly, if you have an opinion about the direction of CDS or, you know, an interest rate movement and you're properly margined with a qualified swap clearing member, you should have access. And, again, it's about too big to fail and too interconnected to fail. So, it's about bringing in greater transparency and more participants in the market.

MR. OLESKY: I would agree with that. I think I could speak from our own experience. We have thousands of clients that are on our system, and we have unbiased access rules that apply that just set up certain standards that we need to have as a business to maintain the integrity of our business. So, I think there are, at a minimum, certain standards that you need to have. They should be impartial; they should be unbiased; and they should be transparent. And there are, in fact, for example, in our markets the Treasury market, for example, which is not the subject of this discussion, where we have standards for

liquidity providers to be primary dealers as designated by the Fed. And the reason we have those standards is that the thousands of institutions that trade U.S. Treasuries around the world when they come on to Tradeweb, they want to know for certain that they're going to be able to access the liquidity that is part of the relationship that those primary dealers have with those customers. So, at least on our system we're open with out standards. We have over 40 liquidity providers around the world and several thousand takers of liquidity, but we do have certain access criteria that we apply that we're transparent with in order to support the integrity of the system and to continue, frankly, to have clients come to our system to access liquidity and use us as a commercial entity.

MR. HILL: We share the views expressed that, you know, anyone who wants access to trading should have access to a SEF. I mean, I think that goes without saying. The more trading the better as far as we're concerned. We also think there

should be multiple SEFs. We think the statute allows the CFTC and the FTC to define SEFs, to allow for different types of SEFs that act differently and can be, you know, customized for the types of users who want to use that SEF, so we think that there should be multiple SEFs. There should be multiple formats, you know, among those SEFs, and whoever wants access to trading should have access to trading. We don't think there should be any barriers.

MR. SHORT: I think I'd just like to point out some of the interconnected issues here, and one thing we haven't really defined is what exactly is a SEF, and I agree with most of what my co-panelists have said about having proper access to SEF, but I think with SEFs I think one thing that has to be considered is what is a SEF and how are these new forms of trading entities going to discharge the core principles that they are charged with discharging, and I think that in turn feeds in to this question about which SEFs can hook to the clearinghouse, so I think there are a

lot of questions that still need to be answered before you can get to the conflicts question.

MR. DeLEON: This is Bill at PIMCO. You know, that concept of using a SEF, I think it should be free and open access. I agree with the panel as well. The issue is that there needs to be a guarantee that when you access a SEF, that when you do a trade, that there is someone who is guarantee that that is a good trade. So whether that means that there's a market maker, sort of someone to (inaudible) that facility, or if that means that there's a DCM or an FCM or someone who's going to guarantee that they're going to stand behind force of unknown clients. As you see in the current futures market, we can trade anonymously and to a position that you go till you're clear. We're a different -- need to know that when you access or think there's a market will work and you'll multiple SEF and the market will behave quite well. If you have a situation where when you pick up the phone, do an SEF, you do a trade, you know which one to be a good trade

because there's going to be someone who ensured that there's another side of the counterparty that stands into it, and then there's a good, clean mechanism to get that trade given up into a CCP for clearing. And the market should work very well, and you could have situations where there are quite a few SEFs and a limited number of CCPs.

MR. COOK: There seems to be a consensus that open access to a SEF is a good thing. I think the issue we need to struggle with is how do we make sure that happens and what are the potential conflicts that we need to anticipate and prevent in order to ensure that there is open access, and going back to a statute again, we meant to consider potential rules governing ownership and voting and control of a SEF by particular types of parties in order to ensure that outcome. So, it would be helpful if we could hear what should we be worried about here if our goal is open access? What types of conflicts do we need to try to anticipate and prevent against happening? And are there differences in the types

of pressures that those particular parties mentioned in the statutes while participants, bank holding companies, et cetera, should we think of them differently or are they all just one cup of kind of just homogenous types of entities that we should treat the same?

MR. KASTNER: Robert, let me try to highlight a couple of the issues here which address somewhat open access and ownership but also one of the main issues. If you look at the progress of the legislation into the final hours was the notion that a SEF may operate by any means of interstate commerce. A previous version of the Bill required electronic trading, and so the issue is can you trade swaps with two paper cups and a string and carrier pigeons, or is it required that they be on a screen, an electronic screen?

And another issue is should you have a request for quote model or should you have a fully disintermediated market where anybody can join any bid and offer and anybody can participate in an open way?

And I would draw your attention to page 345 of the Act where it discusses rule construction, and it says the goal of the section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency. Now, the only way that you can have pre- trade price transparency is if it's on a screen and everyone can see it ahead of time. So, I think that's one of the main issues as you are thinking about the definition of the SEF and rule construction and electronic versus, you know, carrier pigeon when you think about requests for quote versus disintermediated market that you need to consider.

MS. SLAVKIN: Another issue I think arises in this context is the question of the timeliness of information received by various players in the market. I understand that the SEC has probably been looking at the issue of collocation with regard to the exchanges, and I see this is a potential issue that could arise as well in the context of the SEFs, and I think it's

important as you guys consider potential conflicts of interest to also consider who's getting what information, when they're receiving it, and what they can do with that information once they receive it.

MR. OLESKY: If I could just quickly hit on the point Mr. Cook made -- or the question -- about conflicts of interest and how they relate to ownership or governance, try and respond to what you were -- part of your question.

I think it's really important to recognize -- for all of us to recognize -- that market participants really engender many market facilities. And in my experience in the investment of capital and the knowledge about a particular space has led directly to innovations and advances both with Tradeweb and another company I was with, BrokerTech; exchanges; clearing corps. If you go back in history, those are the folks that have the capital to support this innovation and the knowledge and experience to move it forward. And while it's easy to sort

of be critical of that group, I think it's also important not to cut off that flow of capital into innovative organizations that are really groups of market participants that are investing in these types of mechanisms.

Tradeweb was started in 1997 with the internet with a group of banks. We had four banks initially. Then we sold 100 percent of the company in 2004 and we weren't owned by any banks for 4 years. Then we had another investment back in, and we had a minority stake by some banks. I think we really have to separate out the ownership argument from the governance argument, because it's critical to be able to access that capital for entrepreneurs and for innovators when they're trying to build these mechanisms.

MS. SCHNABEL: Darrell or Randy, I just wanted to make sure that you had a chance to participate.

MR. DUFFIE: Yeah, I wanted to go back to this issue of open access. We talked earlier about how the members of the clearinghouse should

determine what gets traded, and we also have conflicts of interest arising from the incentives of the dealers to profit from bid versus ask on products that are not traded on swap execution facilities. So the interaction effect here is effectively if one gets cleared as one gets traded on a swap execution facility, then we want to be very careful that the members of a central clearing counterparty that determine what gets cleared and, therefore, have control over what gets traded on swap execution facilities are the members that have, you know, the right social incentives to create competition. And, therefore, I would like to revisit the point that Mr. Hill made earlier that you need to be very, very large in order to be a clearing member. This has this interaction effect with creating competition.

If you -- I fully agree with Mr. Hill about the clearinghouse in aggregate needs to have the size -- capacity to wind down failing positions.

MS. SCHNABEL: Oh, no, sorry. I don't

know exactly what happened, Darrell.

We're going to try to reestablish the link to Darrell as soon as possible.

Maybe while we're waiting to reestablish the link, maybe the panelists could sort of expound on what he was saying, sort of in that context of where there's a link between what gets cleared and what gets traded and potential conflicts with respect to the decisions as to what gets traded or cleared?

MR. KASTNER: Well, I think where he was going is the clearinghouse clearly has to be stable enough, and there's got to be sufficient capital, and there's got to be fair, publicly disclosed, transparent requirements to become clearing members. But where I hope he was going before he got disconnected was to the point of it's not if your smallest clearing member fails, and it's about creating the right incentives where there is sufficient diversity, and maybe the number's not 5 billion -- maybe it's 500 million or maybe it's 200 or whatever the right number is

-- but it's certainly not an arbitrary thing like you've got to have a trillion dollars of swaps to be a clearing member.

MR. BERNADO: I agree that there shouldn't be arbitrary rules. The rules, again, should be related to the ability to absorb losses and the ability to manage risk, and, you know, I think all the different CCPs that are out there currently have different rules for this. And, again, I think, you know, I would encourage you to talk to the risk managers of each individual clearinghouse either separately or as a group for them to better articulate than probably any of us have their concerns around clearing membership criteria and what they think is the appropriate level, because they're clearly independent of, you know, any of us. And I think what you'll hear is they think, again, that they need to be of sufficient size and sufficient expertise, and maybe the numbers -- 500 million, maybe it's 5 billion -- I have no idea, but the clearinghouse risk managers are the best people to talk to about

that.

MR. OLESKY: Don't we really want to create a model here that just creates an environment for competition among business -- you know, business models and business ideas, and I think that this applies across the board to the clearing corps., the SEFs, the exchanges. We want an environment where there's competition. We've heard it from different participants and different perspectives -- competition among SEFs; competition, frankly, among clearing corps.; competition among exchanges; competition among banks; competition among a broader group of banks. I think that really should be -- you know, the linchpin here is creating a set of principles and regulations that allows for that competition.

MS. SCHNABEL: Okay, Darrell, you're back on. I'm so sorry. Can you hear us?

MR. DUFFIE: Sure. Sure. I'm not sure how much my point got across, but, again, 30 membership will eventually have some influence over competition in the execution side of the

business, and therefore I want to revisit this issue and that one must be a relatively large player in order to participate in a clearinghouse. Once one has the aggregate size necessary to wind down failing positions, I want to understand why additional 30 members that are not large would reduce the ability of the clearinghouse to wind down failing positions. And if that='s not the case, then perhaps wider access is important.

MR. LIDDEL: Hi, this is Liddel. To answer that question, one of the things that we've got to apply to all CCPs, Mike, if you look at some of the waterfall structures that currently exist, the way they are written, and if the counterparty that just (inaudible) goes down, depending on how catastrophic it is, the members may not have sufficient capital to support, and then the people using them as a clearer could possibly be hit. So to the extent that they don't have expertise and capital, by using a certain CCP -- using a certain DCM through a CCP, you are taking additional counterparty risk. So, it is

important to think about it from the standpoint that there does have to be additional counterparty and credit review there, because you are facing both the Exchange as well as your clearing member. And Jim can probably expand on that more (inaudible) than I can. In addition, it's really important to note that it sort of a conflict in terms of what gets traded versus what gets cleared and whether or not it makes sense to have either those -- the people deciding what gets cleared, what gets traded. At the end of the day, the point about this is to reduce systemic risk to the system and give people access to better counterparty controls and have less credit risk. We hope in that process this is viewed as a utility, but, you know, competition should be -- while it's important should be secondary to ensuring that the system does not become more risky. And I think there have been several examples outlined earlier today of things that could be traded and could be cleared, but the reality is there is no good risk management or

pricing for these things. There are certain CDS that trade twice a month, 10 million (inaudible) dealers. I'm not sure I want that on an exchange, because someone could build a very large position in that, and no one has a clue where or how to trade that. And that is the type of thing that costs them a lot of money for a certain system in the program.

MR. HILL: I just wanted to go back to what --

MR. KROSZNER: Okay, if I might jump in here. It's Randy Kroszner. I think this is getting in exactly the right issue about the role of risk management, because we're now at by giving very strong incentives to get things onto the (inaudible) platforms making everyone interconnected to the clearinghouse. So, in order to avoid the kind of conference crises that we saw, the clearinghouse has to be seen as very strong, seen as basically bulletproof so that an individual member going down won't cause the cascading -- the sort of cascading concerns that

we saw in late 2008. And so it's crucial that members have a very -- have the right incentives for risk management. It may be difficult to have two types of members on the exchange, but they might have different incentives to get their approaches to risk management, that you have institutions that have very little capital, because they might be willing to take more risks and want the exchange to or take the central clearer as well as the exchange to take more risks than otherwise.

And a number of people said the point of trying to migrate these things onto central clear platforms and potentially on exchanges is try to reduce those risks since you've got to think about the incentives that people with different amounts of capital might have for ensuring good risk management. This has been -- but as I said before, this is exactly the struggle since the 19th century that clearinghouses and exchanges have had trying to get more things onto the exchange, but also making sure that what is on the

exchange is something that can be -- that the risks can be managed by the exchange or by the clearinghouse.

MR. HILL: Just to expand on that point for a minute, we've been focused very much on what happens when a member defaults and you have to sort of unwind the portfolio or inject more capital into the clearinghouse. But the related piece is who can inject risk into the clearinghouse. So, the clearing members, in addition to contributing capital to the clearinghouse and margin, they interact with their customers and put trades into the clearinghouse. And because the FCM ultimately has a risk to its customer, if its customer defaults, the FCM has to carefully risk manage the amount of trades it takes from any one customer and puts into the clearinghouse. And so not only do you have to be worried about someone's ability to fund the clearinghouse in a default scenario, but you have to be concerned that and focused on their ability to risk manage their customer relationships so

that they don't put trades into the clearinghouse that could otherwise destabilize the clearinghouse. So, it's not just a wind- down that you have to be concerned about; it's the injection of risk into the clearinghouse as well.

MR. RADHAKRISHNAN: Jonathan, I think you wanted to make a point.

MR. SHORT: I wanted to echo some of the points made earlier, and I'd also just note that I think if you'd get the governance of the clearinghouse right, a lot of these problems will go away, and I know that's the topic of the next panel. But I would just like to go back and reiterate that risk management here is paramount. The reason there is a mandate for clearing in Dodd-Frank is to make the financial system more stable, and I realize there are conflicts that have to be dealt with, but I have never heard the Dodd-Frank Act described as, you know, an act that was aimed at, you know, simply promoting competition among financial institutions. That really wasn't the gist of what we were doing here,

and, you know, while all of these things need to be considered and balanced, I want to reiterate that if you create a system that allows too much risk or unmanageable risk to come into the clearinghouse, we're going to be right back in front of Congress again with hearings and major problems, and that is the paramount thing that I think people should take away from this when they're looking at these questions.

MR. RADHAKRISHNAN: Now, I'd like to ask a question, which I expand upon what Darrell said, which I think is a good segue to our next area, which is I think it's sad to say that apart from the mandate to clear as many OTC instruments as possible, the other mandate is to bring transparency to these products through the listing of them on exchanges and swaps execution facilities. And I think, if I might pick on Darrell's point, and the point is -- and correct me if I'm wrong -- it's entirely possible that by not clearing a large group of swaps, there will be no trading requirement, because, one, if you -- at

least from the CFTC, you know, part of the world -- you're dependent on DCO submitting swaps to be cleared and then, you know, there's a comment process and so on. And, two, the Commission on its own has to make a determination as to whether a group of swaps has to be cleared. But if the Commission makes a determination that said this class of swaps has to be cleared but nobody wants to clear it, and let's say nobody wants to clear it for, you know, nefarious purposes, then, one, it won't be cleared; two, it won't be traded. So, how do we make sure that the governance structures -- how do we make sure that we take care of the conflicts of interest to make sure that, you know, what I consider to be the mandate of Congress is not somehow blocked?

MR. KASTNER: This is the -- this goes directly to this Lynch Light section 726. The idea is I agree with you a hundred percent that we could run the risk here if we don't manage the governance properly where certain DCOs just sort of refuse to engage. Now, certain things -- I

mean, it would be very difficult to say that a, you know, plain vanilla interest rate swap is somehow unclearable. I mean, people have tried to say it before. You know, ooh, it's so complicated, it could be annual money; it could be, you know, actual 360 or whatever. But I don't really see that as a risk. I think that the issue is making sure that the risk committees of these DCOs are transparent, that you know who the membership is, that the decisions that are taken about whether to permit new clearing members and whether to permit new products to be listed are transparent and readily appraisable, and so that everyone knows, you know, what's going on so you can -- I think the word you said was "nefarious." You know, you want to make sure that things are being done in the public interest to protect the American public against another financial calamity, not to preclude for some, you know, bizarre reason a product going on or a new clearing member, and that applies. So, transparency -- it not only applies in prices of

securities and security-based swaps and everything; it also applies in governance. So, this is an open hearing, right? There's a public record. There's cameras. There's recordings. The same type of transparency should apply to DCO governance so that everyone is clear about how decisions are taken and how they're made and who's making them.

MR. SHORT: I agree with what Jason just said. I think if you get the governance right, a lot of this goes away, and I think there should be an open dialog with the regulator, independence on board so that you don't face this situation where, you know, for a nefarious purpose things are kept out of clearing. But, you know, I would note that there is a financial incentive on the part of most clearinghouses to clear clearable swaps. It's in our interest to do that, so I think, you know, if you get the governance right, a lot of this -- a lot of the rest of it should fall into place.

MR. HILL: I would like to echo that we agree with both those points and also want to add

-- remember that in most -- I think most if not all of the different product areas there are multiple clearinghouses competing with each other. So, and credit in the U.S., you have ICE and CME and others, and rates, you have LCH and CME and others, and these are all profit-making institutions and, you know, they're going to balance their desire to make money and clear as much as possible with their own internal risk-management concerns about what should be cleared and not be cleared, and I think that competition will go along toward making sure the right balance is struck.

MS. SCHNABEL: Darrell, I just wanted to make sure that you had a chance to speak again.

MR. DUFFIE: I agree with those points that have just been made.

MS. SLAVKIN: I just wanted to --

MS. SCHNABEL: Sorry, Heather, please.

MS. SLAVKIN: Sure. I just wanted to add on, on the governance issue, that I do think it's important in addition though to transparency

and independence I think having real experts on the boards of directors is a very important issue. We all saw situations in the last several years where there were boards that were two-thirds independent and made really stupid decisions about risk management. So, we need to make sure that there are people on those boards of directors that really understand the risks that exist within a clearinghouse and are prepared to perceive potential risks that may arise in the system down the road and address them. So they also need to have the personalities to stand up to a board of directors that may be entrenched and have their own interests that may differ from those that are in the best interests of the systemic stability.

MR. SHORT: I want to just add something to what Heather said. I mean, she's right, but I just want to point out that there really is a tension there, because some of the people who are best qualified to assess risk in a given market are the people that some parts of the -- you know, of the market are complaining about is controlling

clearinghouses and controlling key infrastructure. That's just the fact, and not saying that they're the only people that can do it, but I think when we're assessing good governance and who should sit on boards, who should sit on risk committees, the idea of excluding the very people that have the most visibility into the market is not a very wise decision from a risk-management perspective.

MR. NAVIN: I would second those remarks. Our experience has been that we've benefited greatly from the expertise of industry directors, and I think it would be throwing the baby out with the bathwater if substantial restrictions on industry governance were to be enacted.

MR. ALVAREZ: Excuse me, I have a question. How -- we kind of have conflicting points here. We need enough independence by having enough public directors, but we also need to preserve the expertise, so how are we to strike that balance?

MR. KROSZNER: This is Randy Kroszner.

If I might, I think this gets back to the transparency point, but I do think it's extremely important to have people with the knowledge, the wherewithal, and with their money on the line having input into these risk-management decisions, and I think the best way to ensure that is to ensure a very, very transparent process so that outsiders can evaluate and provide the commentary and the independent directors will have enough wherewithal, enough knowledge to know what is going on. And also what I think could be very valuable in these prophesies is not just to make them transparent so that you can see how the decision is made, exposed on an individual contract, but something that could very valuable is for principles to be outlined in advance of what types of contracts can come onto exchanges, how the decision process will be made. Because one of the things that we're trying to accomplish with Dodd-Frank is a migration of some of these contracts onto essentially bigger platforms. Providing a roadmap for how to do that will help

to encourage market participants to restructure contracts to make them in a way that -- or write them in a way that will be more readily clearable. And so I think you get a double win on that of bringing more over-the-counter types of contracts onto exchanges and you'll have a much a transparent process. Because I think it's good to have the process transparent not only ex poste after the decision is made, but also ex ante what kind of principles they used and how the decision will be examined or how the decision will be made.

MR. DeLEON: This is Bill at PIMCO. I just want to point out that there is quite a bit of transparency already, and there's a second check on the risk-management process that any DCO will use, which is that end users will decide whether or not (inaudible). And if there is sort of a race to the bottom in terms of not charging sufficient capital or having good risk management, end users will not want to use that DCO for clearing. So, you will naturally see and move away from them, and if you look at the current

models that are employed by the exchanges, they tend to be conservative, and it's pretty easy to be transparent when they change margins, because you need statements from them saying they've gone up or they've gone down and you need to post right away. So, I think that process already is in place and works, and at the end of the day as there are more DCOs, end users will make a very loud vote with their feet in terms of where they put their capital, because if someone's charging a lower rate or has very low margin, you know, at the end of the day people who have fiduciary responsibilities to manage clients' money will have to go well, it may be cheaper but it's not going to provide the protections I need; I don't think I want to use them. So, I think there is a natural mechanism in the market to enforce that.

MR. RADHAKRISHNAN: We need to move on to exchanges -- to contract markets and national security exchanges, so --

MR. WORKIE: Can I just ask one more question? It's going to relate to all the points,

and then, Shawn, if I could (inaudible) I tried to get in a couple of times today.

You know, a lot of questions, a lot of the discussion I've heard is related to complex as it relates to kind of members of the clearing origination or potentially members of the SEFs. Are there any financial institutions that are not members, because the Dodd-Frank doesn't spell it out between members and non-members. It just lists financial institutions. So, with respect to the group that's non-members and are financial institutions, are there conflicts with respect to those that we should be considering, or is that really just tied into those that are actually members?

MR. BERNADO: Well, what I wanted to say was, just to go back to the original definition of "SEF," it says "trading"; it doesn't say "trading facility." And to go back to what Jason mentioned about any means of interstate commerce, there are multiple modes of interstate -- of -- I think what was intended was there are multiple modes of

execution in what we do -- voice, electronic, and hybrid. It really depends upon the product. The more liquid products, like Lee said, in U.S. Treasuries, it's highly liquid, it's very efficient, it trades fully electronic on screen, but some of the less liquid products don't -- they need voice intervention. They need to provide that liquidity to the marketplace, and to keep the markets moving you need to have voice -- you need to have the multiple modes of execution that was mentioned before in regards to interstate commerce. I don't think that answers the question that you just asked.

As far as institutions or different types of institutions, we're open to having multiple participants on platforms, which we currently do.

MR. KASTNER: If I could try to answer your question directly in terms of other conflicts of interest, apart from clearing members, okay, it's about access to clearing, so there are -- the membership of the Swaps and Derivatives Market

Association. There are over 20 firms who would love to get into the business of trading interest rates, swaps, and CDS with our customers who, by historical accident, credit rating, or for whatever reason have not developed that capability and who need access to clearing. So, it's not just about becoming a clearing member of an exchange and who gets to be a clearing member. It's about who can open a clearing account with a FCM, SCM, whatever, and the point is if you have a firm who is doing customer business and wants to engage in an interest rate swap with an end user who is not a clearing member, that they should be able to execute that trade with the end user and then give up to a clearing member. So, what it does is it allows more participants to diversify the risk. Some of them may not be big enough to become swap clearing members of an exchange, but they're certainly big enough to take the other side of a $100 million interest rate swap. Do you see what I mean? And so that's one of the key issues that goes back to this issue of opening the

market and bringing in more competitors. And so that's something that I think that you really should focus on in the rule-making stage.

MR. COOK: If -- taking -- just to build on that point, if one's concerned about preserving the access to membership, as you point out is a central issue, and tie it back to Haimera's question, does one take from that that your primary concern is that the control over access is with dealer members? And so if you have dealers who are not members who may have an ownership interest, you are indifferent to that but because you really think that the conflict is between the dealer members potentially restricting access by non-dealer members, other types of financial institutions who aren't members of the clearinghouse, there's no conflict of interest?

MR. KASTNER: The problem isn't with, you know, dealer members restricting customers from being clearing members, right? They're more than happy, you know, to, you know, use a name. You know, PIMCO is a member of the panel. I'm

sure any number of investment banks would be more than happy to open a clearing account for a buy-side institution such as that. The issue is if there is a sell- side institution that wants to do a trade with PIMCO, just to use an example, that isn't a clearing member, that requires access to a big financially important clearing member's, you know, capital base in order to facilitate that transaction now, that other firm, that other smaller, independent investment bank firm that wants to do that trade -- we need to have a system where they can do that, because what we don't want is the same 10 guys holding all the risk and then concentrating in the clearinghouse. The idea is, you know, introduce more participants who have access to clearing in order to facilitate that business, and that's where there has, in the past, been a bit of tension. I'm sure that given the various anti-trust provisions in the Act, as well as the ability of this Commission to issue cease-and-desist orders, that these problems will probably go away, but it's something that you need

to keep an eye on.

MR. BERNADO: And, again, having a vertical -- having both the clearing and the execution definitely creates a problem, because there are so many means in which when you have the execution facility and you're competing in our space, which is what we do as SEFs, when you don't allow our customers, who are also the customers of the exchanges, to submit the trades the same exact way or do certain things, they can definitely create biases, which they currently do. I mean, we experience that today in certain markets where the exchange also has an execution platform that competes with us, and we cannot submit our trades to that clearinghouse the same way the exchanges' customers, who are also our customers, executing the same type of trades can submit to the clearinghouse. So, that's without question a conflict of interest that goes on today. It's a major problem with having a variable.

MR. HILL: Right. We reiterate that point that we think the clearinghouse should be

agnostic as to which SEF they accept trades from, and the SEFs should be agnostic as to which clearinghouse they send trades to. I'm sure that would be a --

MR. OLESKY: Yeah, we do, and that actually is our policy at Tradeweb. We actually have that approach. I'll just echo the comments that were just made. I think that there's also a statement about equal access, and then there's the reality of actually truly having equal access, and that gets down to really connectivity, technology, cooperation, cost differentials that are really the nuts and bolts of how do you actually really get equal access. So, as much as I think everyone will agree that everyone should have equal access, it really needs to be detailed so that there is not a bias that's applied subtly, which can happen and happens today when there's a -- and I understand it, because there's a conflict. There's a conflict where we will be competing with a part of a clearing partner. So, there's a built-in conflict there.

MR. ALVAREZ: Yep. Moving away from SES for a moment, talking about DCMs now, what are the similar types of conflicts that you're going to see with DCMs as clearing swaps?

MS. SEIDEL: And I echo that question with respect to exchanges as well, sort of the existing trading markets versus the new ones that the Act puts in place. Are there any similarities or differences and concerns about conflicts with respect to trading?

MR. HILL: I think the exchanges currently -- I think most if not all have this vertical model where if you trade on an exchange, you have to clear it through their clearinghouse, and I think the rules that apply to SEFs should apply to exchanges as well. It should be open access.

MR. KASTNER: Let me give you a specific example. One of the members of this SDMA currently clears 13 percent of the business at a large exchange in Chicago. That large, independent FCM is clearly qualified to become a

swap clearing member. But because of various conflicts of interest, the risk committee of said exchange is precluding that firm, which is clearly qualified and has the capital, from becoming a swap clearing member. They're more than happy to let -- you know, they remain an FCM in good standing, but in terms of branching out and entering into these new products, a very motivated firm which wants to open clearing accounts for our members is currently being effectively shut out, and those are the types of things where -- this goes back to the governance point and transparency about who's making that decision and why, because a lot of times what happens is people will swallow themselves in the cloak of risk management or financial stability or whatever really to make an anti-competitive stand. In other words, you can never say that you don't want to let somebody in. But you could probably find an excuse or a reason in the interest of systematic -- you know, systemic stability and the rest of it to put an asterisk on the application or just delay it for

awhile. So, those are the types of issues I think that we need to be looking at.

MR. RADHAKRISHNAN: So, let me follow up on that. Let's say, for example, you had a clearing organization exchange would say in order to be a clearing member you must have capital -- regulatory capital of a billion dollars, let's just say, as calculated in accordance to SEC-CFTC rules. So we know that it's what I consider true $1 million -- safe $1 billion. And let's say somebody comes to us and says you know what, we think that's unfair; we want you to lower -- we want you to cause the clearinghouse to lower the capital requirement. So, by somebody in charge of clearing, I'm kind of reluctant to tell somebody I think you need to lower the capital requirement. Well, unless you give me very good reasons.

What are those reasons? What would cause either Robert or I to go to a clearinghouse and say, you know, I think you need to lower the capital requirement?

MR. KASTNER: So, it's not only about

the capital requirement. I agree that not only would it be imprudent to have requirements that are too low, but that also in terms of what the American public's perception would be of a regulator who's going around telling exchanges to lower their capital requirements after we just had a huge blowup. I mean, that's a big ask, right? But it's not just about capital, which needs to be set at a fair level. It's about -- if you get in these discussions -- let's say, for example, you have a firm that has the billion dollars of capital. They'll make some arguments, some operational expertise argument, and again it goes back to this chicken and the egg things. Well, you don't -- you've never cleared swaps before, so you can't clear swaps. You see? Or let me give you another solution. You permit a joint venture between a large money center bank, which has a ton of capital, but relatively meager operational expertise. And FCM that is very strong in operational management; a SEF that can provide the necessary pricing information and assist in a

default management procedure. So, it's not just about, you know, drawing a line in the sand and making that bar higher and lower. It's about being clever about how we actually look at risk and manage risk and how do you actually come up -- what is the right number, you know?

What is the sigma of an earthquake in San Francisco, you know? I mean, what is the answer to that question? Is it -- if I had a billion and one dollars I can trade as many as I want, but if I only have 200 I can't trade any? The point is there's position limits, right? And the amount of risk that you introduce is proportional to the amount of capital that you have, that you're clever about managing the margin, that you're clever about managing your risk, that you're a savvy trader, and that a guy with, you know, 500 million in capital can't clear as many interest rate swaps as a guy with 5j bazillion, but that he can clear some, that it's somehow proportional. So, the CFTC does not have to go and say to the exchange you must lower your

barrier to entry. What you should do is say you must make trading ability and clearing ability proportional to the capital that you have.

MS. MOORE: You know, are these issues unique to the swap and security-based swap market? Because we do have member-controlled institutions today that act as utilities and provide for open access. So, you know, I just wanted to know how the conflict of interest issues, you know, are viewed with respect to the swap in the current markets today.

MR. HILL: I think the conflict issues are similar. I think the risk management aspect of this, though, is certainly more heightened with respect to OTC derivatives even once they're traded on SEF, for example, than they are for the sort of highly, highly liquid exchange rate of products that you might see in the future as well during the -- or, you know, in the stock exchanges, and that's simply because by definition these products are less liquid; they're more complex. And so the skill level in risk managing

them, or the expertise level in risk managing them is higher, and I think your sensitivity around -- or the clearinghouse's sensitivity around ensuring the right to participate is probably heightened. And I think that's just a function of complexity and liquidity.

MR. SHORT: I want to add to that -- I think your question is are there differences between the existing derivatives markets and the equity-based derivatives markets, and if that was your question I think they have come from very different places and, you know, one of the things that I struggle with is, you know, it all sounds very good on paper to say let a thousand flowers bloom, we'll have hundreds of SEFs. They'll all hooked to a clearinghouse and everything will be great. We've got competition, but there are some very real issues that I think are going to be very difficult to work out in terms of how the DCO discharges its regulatory obligations. We've got an Act that talks about having position limits apply across markets, across venues.

You know, there are a lot of questions that I think we haven't even begun to get into here that may impact the ability of a particular SEF, for example, to hook to a derivatives market. And I know I've heard a lot of people hold the equities market up as an example of how you have multiple execution venues and everything is great. I don't think everything is so great. I mean, we've had flash crashers; we've had problems. You're talking about -- and when you're -- I just want to emphasize this point. When you're talking about risk managing derivatives in our world, you're talking about managing risk over a very long time horizon. And clearing of these derivatives is very complex, so I'm not saying that this is something that should preclude open access. But I think we need to go into this very carefully, and I think we need to consider how all of this actually bolts together in the real world and allows the markets to be properly regulated, because I think there are a lot of regulatory objectives here that we haven't talked about.

MS. SCHNABEL: Heather. Heather, I thought you wanted to say something. Did you --

MS. SLAVKIN: I was just going to further expound, I guess, on the point that Jason was making earlier about the importance of not allowing the argument that we're having right now about the need for capital requirements to become a bar to entry for smaller players. And this issue really echoes issues that arose in the debate around capital requirements for the large financial institutions that occurred in the process of developing the Financial Reform Bill. And one of the big issues that people were talking about was whether progressive capital requirements were the way to go, because, you know, saying -- you know, if you look at the 5 largest financial institutions that control 90 percent of the market and say that's going to be the bar for how much capital you have to have, the amount of risk and the amount of activity that those institutions are engaging in is not the same as the amount of risk and the level of activity of the smaller players

in the market, so it doesn't make sense to hold them to that high standard. And I think it would be important here to try to consider the possibility of creating requirements, have progressive capital requirements that consider volume and size and activity and risk when you're determining what the appropriate capital requirement should be for gaining access to a market.

MR. KASTNER: And I would also direct your attention to the antitrust provisions where the Commission has been directed that unless necessary or appropriate to achieve the purposes of the Act, you shall not adopt any process or take any action that results in an unreasonable restrain of trade or impose any material, anti-competitive burden on trading or clearing. So, unless you've got a really good reason to have a trust or a monopoly or some, you know, closed system, there is a clear directive here and there's clear remedies as well. So, I think that as you think about it, and as you think about risk

management, you have to balance those risk management arguments against various other clear calls for a lack of anti-competitive behavior.

MS. SCHNABEL: Okay, I think that we're counting down to the end of the first panel, so I just wanted to throw kind of a general observation out there.

It seems as if one of the themes of our conversation is we need to figure out how to not inject systemic risk in clearing and listing of swaps, but then we also have to balance that against the systemic risk that would exist if bilateral swaps are not cleared or listed because of certain incentives. And so I guess I would just welcome the panelists to give their final thoughts on this subject on how the balance can be achieved.

MR. RADHAKRISHNAN: Let's go down the lines.

MR. SHORT: I would just say that -- one other observation -- I don't think this is going to occur in a vacuum. My understanding of what

happens under Dodd-Frank is that for swaps that are not cleared, there are prudential regulators who will be looking at the capital that has to be held by a given bank or market participants, so I think there are going to be other levers that are pulled that move things towards clearing.

MR. NAVIN: I think it's very important that the risk managers be left to manage the risk, and I think that there may be situations where they have conflicts of interest. There may be situations where in fact they're being exclusionary. And I think in those situations we've got to rely on complaints by the people that are being adversely affected to the regulators and on appropriate response by the regulators. I don't think they can close their eyes to restraints of trade. But I think a regulator has to be very careful in second guessing experience to risk managers.

MR. OLESKY: That's pretty much what I was going to say, Bill. You know, this is a really tough thing to balance. We do this all the

time, and for us it's about the integrity of our platform, the integrity of our system, and so what do we do when we make a decision to get into a new product line, a new business? We started trading derivatives in 2005 -- interest rate swaps. What do we do? We listen to the market participants, which is what we're doing right now, and I think really try and figure out, okay, what can legitimately work here, what will be the right balance between, you know, getting the risk into a clearing corp. and having standardized enough things, traded electronically, traded over voice through a SEF versus pushing things beyond what is really going to work in the marketplace, and so I think it's this balancing act. It's a challenge, but I think it's this process that we're going through of kind of engaging with the market participants that'll get us closer to the answers.

MR. HILL: I would probably reiterate what Bill said, which is that ultimately the risk managers of the clearinghouse are the ones who need to figure out how to manage these risks and

manage these conflicts, and as I said a few times earlier I would certainly encourage the CFTC and the SEC to reach out to those risk managers to get their direct views on how these risks and these conflicts are best managed. I think getting a cross section of the market to opine is useful, but ultimately we have to get this right. The primary purpose of Dodd-Frank was to reduce systemic risk. That risk will now be concentrated primarily in the clearing houses, and it is critical that we get the risk management correct.

MR. KASTNER: I would close by referring to Chairman Gensler's comments on July 15th when he commented on the passage. The essential point is that we have open platforms that are transparent to protect the American public. So, we have to act in good faith. We have to have openness and transparency.

MS. SLAVKIN: And I think the question you asked echoes the question that the people who are drafting this legislation were asking that took them several hundred pages of legislative

text and almost a hundred rulemakings for you guys to try to figure out the answers to, and I think that, you know, conversations like this with market participants at the beginning of the process of determining what that right balance is, and I agree it's going to take, you know, the risk management staff at the clearinghouses as well as diligent oversight by the regulators.

MR. BERNADO: I think that -- I keep hearing people say "listed," and I think the listed implies that you're looking to push things on to exchanges or it implies that, and currently -- I mean, we as the WMBA, the interdealer broker market, already operates efficient markets. And to go back to multiple -- to interstate commerce, there are definitely multiple modes of execution that need to stay in place to keep these modes sufficient, keep them like good, and not to upset the flow of the markets currently. So, you need voice; you need electronic. Certain things will be pushed to get standardized and get pushed to exchanges. But, again, we keep saying "listed."

That's not -- it's definitely a concern. We don't want to upset the markets as they currently are, because we play an integral part of keeping them as efficient as they are currently.

MR. RADHAKRISHNAN: Okay, we'll go to Darrell on the video and then Bill DeLeon and Randy Kroszner on the phone.

MR. DUFFIE: Thanks. I think the most important principles here are incentives. I don't think there's a conflict between the incentives for competition, increasing competition in this market on the one hand and the incentives for improving financial stability on the other, or I don't think there's a problem between those two. You can have going to have both. The incentives to watch for on competition are that we've got enough access by multiple market of participants, and that the oligopolistic nature of the market is, to some extent, watched carefully by regulators. And on the systemic list side I think the incentive issue is that everyone benefits from the safer markets, but not everyone internalizes

the costs and benefits on their own, and, therefore, regulators need to look for those weaknesses in financial stability for which no one individually gets the benefits. And, in this case, clearing and a relevantly transparent system are going to move in the right direction.

MR. RADHAKRISHNAN: Bill?

MR. DeLEON: Thank you. Yeah, I agree. I think that the most important thing to focus on is that it's meant as a reduction in systemic risk as a utility function, which does not preclude, you know, people having access, but you need to set a bar. It shouldn't be arbitrary and it should be fair. I agree that more participants in the clearing space, as long as they meet some bar and it's not a capricious or, you know, sort of exclusionary, will reduce risk to a system and ultimately bring cost down and tells the system. But at the end of the day, you do need to listen to who's doing the risk management. And I think you want to talk to both the current people as well as, you know, other risk managers throughout

the industry and see what they think is appropriate to come up with what that bar should be and how it should function. But rushing to force things on the CCPs with too low of a bar will not accomplish what we're looking for.

MR. RADHAKRISHNAN: Randy.

MR. KROSZNER: I certainly echo those last two sets of comments. The success of clearinghouses and the reason why there's been so much push to try to get many contracts into centrally (inaudible) platforms is precisely because of their success over a century in managing risks. They've been very successful through World War I, World War II, the Great Depression, and we should not do anything that is going to undermine that by forcing things that will -- or forcing types of contracts that cannot be risk managed well onto the Exchanges to -- forcing certain -- using certain criteria that will undermine that risk management. The success has come from being tough about risk management, but sometimes means setting very tough criteria

that some institutions and individuals may not like. But we're now basically betting the system on the stability of these clearinghouses. And if we're going to do that we've got to make sure that they're not going to undermine the stability, but they're going to be seen as bulletproof or as near to bulletproof as any private institution can be.

MR. RADHAKRISHNAN: Well, thank you. With that, we come to the end of the discussion for today, for right now, on Panel 1.

I would like to thank the panel for a very spirited discussion. I think it's very obvious that you'd given a lot of thought to the subject, and on behalf of the staff the CFTC are very grateful for your time and your thoughts. So, thank you very much.

We'll just spend a few minutes swapping out and invite the members of Panel 2 to come up, but thank you.

Thank you very much.

(Recess)

MR. RADHAKRISHNAN: Start Panel 2, which

is Possible Methods for Remediating Conflicts. The topics will be, one, ownership and voting limits; two, structural governance arrangements; three, substantive requirements; and number four, the appropriateness of applying the same methods to each type of entity.

I'm going to ask each of the panel members to introduce themselves and then we'll have questions.

MR. BARNUM: I'm Jeremy Barnum from J.P. Morgan.

MR. SCOTT: Hal Scott from Harvard Law School. I just want to give a disclaimer that I'm also the director of the Committee on Capital Markets Regulation, but I'm not speaking for the committee at this session.

MR. GREENBERGER: Michael Greenberger, University of Maryland, School of Law.

MR. PRAGER: Richie Prager from Blackrock.

MR. LIDDEL: Roger Liddel from London Clearing House.

MS. MARTIN: Lynn Martin from NYSE Life, U.S.

MR. KASTNER: Jason Kastner, Swaps and Derivatives Market Association.

MR. McVEY: Rick McVey, MarketAxess.

MR. BERNARDO: Shawn Bernado, WMBA.

MS. SLAVKIN: Heather Slavkin, AFL-CIO.

MR. RADHAKRISHNAN: Thank you. Andrea?

MS. MUSALEM: Okay, so we spent the last two hours talking about the conflicts -- the potential conflicts of interest and now we turn to the possible methods of remediating those conflicts. The first topic is ownership and voting limits and the first question is: Would an ownership cap mitigate the actual or potential conflicts of interest identified in the previous two hours?

MS. SCHNABEL: Go ahead, Hal.

MR. SCOTT: I should say -- while I'm not speaking for the committee, the one thing the committee did say on this is that they opposed ownership restrictions, so I think I can speak for

the committee on that, the reason being that I think they're counterproductive in getting needed capital liquidity into the clearinghouses which, I think, should be our central focus in terms of systemic risk.

In my view the potential conflicts should be generally handled by board governance rules and not by ownership restrictions.

MR. GREENBERGER: Yeah, I feel exactly the opposite. First of all, what disturbed me about the first panel is talking about this in an isolated and not contextual viewpoint. The problem here, the origination for the Lynch amendment, which put a 20 percent cap on ownership was a concern that then existing clearinghouses were setting their requirements for membership unreasonably high, in a manner that was discriminatory.

It is true that the central tenant of the statute is to require clearing and exchange trading. If you have one clearinghouse dominated by the major swaps dealers, they have several

conflicting incentives. One is, I reject the idea that somehow they do not want to keep a large and vibrant over-the-counter market. We're told that clearing is very profitable. If it was that profitable, where were these people when we were aggressively arguing for mandatory clearing and exchange trading? They were on the opposite side of that. The transaction fees and the spreads still make an unregulated market very, very profitable, probably more profitable than the profits that would derive from clearing. So, if you have the swaps dealers in control of a clearing facility, they have that incentive.

Secondly, if they set their membership so high, they are going to sift away the strongest members of the swaps market and the other clearing facilities are going to be left with everyone else. That does not -- first of all, it's not open and fair access and it will create systemic risk in the other clearing facilities who have to take the leftovers from these clearing organizations.

Secondly, the argument that, for example, ICE Trust, which has nine banks taking 50 percent of the profits, are the best judges of risk management, is belied by the credit crisis we went through in 2008. It was these very banks that caused the crisis because their risk management policies were so weak, and to centralize the too big to fail banks, and they are called too big to fail because there is a recognition that if they fail they will be rescued, that does not make them the ideal risk managers. Added to the fact that, yes, certain products will be cleared because they are profitable and they may over calculate and be over enthused about clearing things that are too risky.

So, the Lynch amendment -- we now have Lynch Light, but the Lynch Light provision is extraordinarily broad, it gives the agencies power to put ownership restrictions in. I'm not saying that ownership restrictions have to be applied across the board, but when you've got something like ICE Trust with 9 banks taking 50 percent of

the profits, those banks have an oligopic residue of power from the OTC derivatives market, they translate it into the clearing, they keep -- they don't have open and fair access, they're making the decisions. I think ICE Trust advertises that its board is independent and I think the very fact that they claim independence when they were the target and poster child for the initial 20 percent restriction demonstrates that having independent directors is not enough.

If there's a problem -- there should be ownership restrictions. It should -- swaps deals -- anybody defined as a swaps dealer or major swap participant should not own more than -- collectively or individually -- more than 50 percent of the market. By the way, Goldman has just announced that it's going to open its own clearing facility. How is that going to be managed?

There are incentives -- and the open access has implications. If they do the clearing, it's been said earlier, they'll have control over

exchange trading. I think the only effective way -- the 20 percent rule was abandoned but you were given extraordinary power. You have the power to put ownership limits in and I strongly advocate that that's the only way you're going to get effective remedies.

You've got to separate -- people have talked about United Trust powers --

MS. SCHNABEL: Michael, sorry, we're just trying to get --

MR. GREENBERGER: Okay, let me just finish. You talk about antitrust as a capability, people complaining about not getting membership as a capability. You do have the power to structure DCOs, but you have to look at all remedies and governance and ownership is a remedy, and that should be adopted.

MR. BARNUM: There were a lot of statements made in there and I guess in the interest of allowing people to speak I won't try to refute all of them, but I think, I guess -- I guess I think it's important that we recognize

that the reason that the Commission is hosting this panel is that these issues are complicated and that there are, in fact, tensions. So we're having a conflict about -- we're having a panel about conflicts of interest and sort of directly related to that is the question of managing the tension between different useful social objectives on a continuum. So, on the question of -- on the question of ownership of clearinghouses and expertise and the Lynch amendment, the -- it is very appealing in principle to imagine that these systemically important financial players into which we are putting much more risk, could somehow be entirely free of the nefarious influence of the evil dealers who contributed to the crisis to quote Mr. Greenberger. But, unfortunately, they are, in fact, the market participants who need to use the clearinghouses.

There is a version of the market structure that you could put in place where they would be entirely state run utilities. You could do that. In many respects, from the perspective

of the dealer community, that would not be a bad outcome for us. We would, in many respects, speaking for J.P. Morgan, be perfectly happy with that outcome. We want to clear more trades. There's a mandate to clear more trades. It's very capital intensive to clear more trades. If you had a government-guaranteed, central counter party run as a not-for-profit utility, that would be a perfectly acceptable outcome for us.

That's not where we are for a variety of historical reasons. Given that, then you've got some very complicated tensions that you have to manage. If the people with the expertise and the people who are paying the bills don't participate in the processes in any way, who's going to do it? What kind of market incentives are you going to create to make that happen?

The traditional vertically integrated exchange model for futures works beautifully in a whole range of respects for those products from the perspective of liquidity and systemic risk, but it has a couple problems. It is -- it does

seem to create some natural monopoly properties. You can debate whether they're severe enough to warrant action or not and that's one of the kinds of tensions that needs to be balanced. In addition, they work very well for the types of products that naturally attract liquidity on exchanges. The whole premise of this is that we're pushing a whole new set of products with different liquidity characteristics into central counterparties. That means that you cannot apply exactly the same framework. There are new challenges that are being introduced. They create tensions. And those tensions need to be looked at rationally in a continuum framework that balances different social goods against each other.

MS. SCHNABEL: Jason?

MR. KASTNER: I think it's not credible to say it's complicated. The law says that you have to mitigate systemic risk, promote competition, and mitigate conflicts of interests, right, that's what the law is. So you have to look at whose incentives -- who -- what incentive

does my distinguished colleague, the professor, have? Is he operating in a socially optimal way or is he operating out of economic self-interest? What are the incentives here?

The SDMA is not here to dance between the raindrops and say it's too complicated, and the SDMA is not here to say that J.P. Morgan cannot have an ownership stake in a clearinghouse. The SDMA strongly supports the Lynch Light provision such that no economically incentivized, monopolistic power can control and restrict access. And I'd like to thank again the professor for his very insightful remarks.

MS. SCHNABEL: Roger?

MR. LIDDEL: To go back to the question, I think with established organizations, then I think the concept of some combination of ownership limits and voting caps actually does make sense. For example, in the (inaudible) clearinghouse, we've got a 5 percent voting cap and have done for many years. And the reason for that was to take away any incentive for anyone to build up a stake

greater than that so that we would be highly unlikely to ever have less than 20 shareholders. That works well for us.

However, to pick upon the point that Lee Olesky made before, I think you have to be a little bit careful in how you treat entrepreneurials or starter ventures because most of the successful starter ventures have started with a relatively small number of banks sharing an interest in creating something which then becomes a lot bigger. So, in general, for established organizations I think it makes sense.

Also in terms of participation, ownership, and membership, you know, there is a risk that I think listening to the debates so far, that the impression could be left that in the case of our swaps business, for example, we've got a limited membership of about ten dealers who collectively control about 96 percent of the market. It's not true. Our membership is actually growing faster than it's ever done. It currently stands at, I think, now 32. We're going

to pipeline, which will take it up 40 within the next 9 months or so, and I would expect it to continue to grow beyond there.

Now, the question is to whether the right number is 40, 50, or 60 is in my view not particularly relevant. The relevant thing is to make sure that the real customer's trades are able to get into the clearinghouse and that we take a lot of the risk out of the system and I think, you know, getting too obsessed with who actually qualifies and who doesn't, given the number is actually reasonably large and growing, is actually not the big issue.

MS. SCHNABEL: Lynn?

MS. MARTIN: I'd like to first thank both commissions for inviting NYSE Euronext to participate in this lively debate as it's been thus far.

Specifically on the topic of ownership limitations and voting caps, NYSE Euronext opposes specific ownership limitations. We think that a more effective manner in controlling conflicts of

interest is around good governance structure at a board level.

You may be aware that NYSE Euronext's U.S. Future Exchange -- NYSE Life U.S., is a semi-neutralized structure whereby we balance the views of both the independence criteria as required by core principle 15 in the CFTC-DCM requirements, as well as the views of NYSE Euronext and our external investor firms' views, such that no one board action may be enacted based on the views of any one of those constituents.

So, it's our belief that a more balanced board structure, a more balanced governance structure, is the proper way to handle or potentially mitigate conflicts of interest.

MR. McVEY: We would agree with that. I think when it comes to ownership we have to realize that we are embarking on a major transformation of OTC markets and all of these entities are going to need capital to provide the market efficiencies that we're all seeking to achieve. And rightly or wrongly, historically a

tremendous amount of the capital for clearing, e-trading, data and affirmation hubs, has come from the dealer community, and I think it would be very dangerous to cut off an important source of capital that can lead to some of the market improvements that we're all seeking to achieve.

I think there are two important components. I think it's important to take a look at the governance structures to make sure that there's fair representation of all important market constituents at the board table and I think it's important to make sure that there is nothing that impedes competition, that different entities have the ability to compete, whether it be for clearing, trading, or data, and it's not restricted to just one entity.

MS. SCHNABEL: Okay, I have a question about ownership. So, I think that right now we're discussing ownership in general and we may be lumping together voting ownership and economic ownership and I guess just going down the line, and people can raise hands, who supports caps on

economic ownership without voting rights?

All right, can you please explain your views starting with Jason?

MR. KASTNER: So, this goes back to something that I was talking about earlier which is the problem is not when the smallest member fails. We've had clearinghouses in this country for, you know, 150 years, and we've had numerous failures along the way. But the notion is too big to fail no more, to interconnected to fail no more. The only way to address that -- or, the most direct way to address that, is to encourage both control diversity in terms of voting rights, but also economic diversity in terms of participation such that you could have a situation where the risk is diversified over a larger amount of members. In fact, it's required because no one person can have more than 20 percent or whatever the number is.

Now, it's not like we're saying no one person can have more than 1 percent, and it's that we're saying that you can't have a 20 percent

stake in 5 different DSOs, but it's all about too big to fail, too interconnected to fail. And if we put stuff in a clearinghouse and it's the same 5 guys in the room, and the biggest 3 of them start to wobble, you know, it's going to be back to Congress with a 1-pager asking for $750 billion, which is not want the American public wants. And so that's why it's critically important that these ownership -- economic, both, and voting, be instituted.

MS. SCHNABEL: Heather?

MS. SLAVKIN: Sure. What I'm hearing from the people who support governance as opposed to real caps on ownership is an argument in favor of the status quo, and I think that when Congressman Brown -- I'm sorry, when Congressman Lynch proposed this amendment that was passed in the House legislation, and when Senator Brown proposed, you know, the Lynch Light version that was passed by the entire Congress, their intention was to create real change in recognition of the fact that the current system is broken. It

doesn't work. That's why we're all sitting around this table today. Governance is a valuable tool, it's not the only tool, and I think it's our responsibility to try to examine other options and I think that the ownership cap is a real valuable tool that can be used to mitigate the problems that exist in the current system.

MS. SCHNABEL: Okay, Roger?

MR. LIDDEL: Yes, I mean, I disagreed, I think, with everything that Jason said except for one thing and that is having the same five guys in the room would be a bad thing, and we certainly would not want to have that small a number of financial institutions dominating any structure, that would not be appropriate any way.

The concept of too big to fail is obviously of crucial importance, but also, frankly, I think the concept of too small to survive in a crisis is also important. The situation today is that every clearinghouse that clears futures in the world, to my knowledge, is capable of managing a default of any one of its

members. It's a well- established process, it's not that difficult, and it can do it reasonably reliably. You've got access to good liquid markets on exchanges to hedge and then you can auction a portfolio relatively quickly and relatively easily.

There is, however, not one clearinghouse in the world today that is itself, on its own, capable of managing the default of an (inaudible) swap participant, including us. And what we need in a venture like that is to call on a bunch of market participants to come in and work on our behalf to manage risk and that creates this sort of mutuality of risk that actually is completely different from the futures markets.

So, I think as we move into this next phase, which is crucially important and very, very beneficial at moving the OTC derivative market onto clearing systems, we must make sure we don't just make the assumption that they then will behave like futures because for the foreseeable future, in our view, they won't.

MS. SCHNABEL: Michael?

MR. GREENBERGER: I find it very troubling that LCH says they do not have the capital resources to clear interest rate swaps.

MR. LIDDEL: No, that isn't what I said.

MR. GREENBERGER: Well, you said you'd have to bring in other parties to help you.

MR. LIDDEL: No, I said we bring in other parties to help us manage the risk, not to provide the capital initially.

MR. BARNUM: I think I may actually be able to clarify this one and I actually think it's an extremely important point that has bearing both on the previous panel and on this one.

The market is obviously changing a lot and there's obviously a lot of friction, and I don't think anyone can argue that the status quo as of, say, 2007, was exactly the optimal, most efficient situation you would have had as a result of totally unfettered competition. However, there was a significant free market element to that market structure and that element was that, as I

said before, the traditional exchange model works extremely well for -- in almost every important respect, for the products that naturally attract a lot of liquidity in that kind of execution structure, and for the products that don't work as well in that structure, the OTC market essentially serves as an outlet that provides different modes of execution and different degrees of customization to serve different needs. I'm well aware that there are arguments about spurious customization and OTC products that should naturally be on exchange, that's fine. My argument doesn't depend on saying that that's not true.

The point is, in the new world, what we are doing is putting a new set of products that did not naturally gravitate onto exchanges, into some parts of the traditional exchange infrastructure, clearing, and then some kind of organized training, but critically it's happening in a de-verticalized way, we're going from a vertical world to a horizontal world. When you do

that and you have a close-out process that you need to execute because of a failing party or you need prices for the purposes of margining at end of day, you don't have access to one single attached trading venue for the purpose of doing that. So, what do you do? You need to do something else and people are developing different models for how to do that, but Roger's point was that the close-out process, which LCH did in fact run, extremely successfully, in the case of Lehman's default, requires the active participation of the clearing members to supply liquidity because the product is not traded through a central (inaudible).

MS. SCHNABEL: I just want to bring the panel back to, I guess, the topic, which is ownership caps. Basically, I mean, what Jeremy just said, I, you know, I want to get some clarification about that because it seems that there is some conflation between ownership and membership and also some conflation between economic ownership and voting equity. And so I

just want to see, I guess, could we separate out each of these elements and who's supporting what? Hal?

MR. SCOTT: Yes. When I spoke, I was saying I opposed ownership restrictions, I was not talking about voting restrictions which I think is a different issue, and the way I would put it is not a voting restriction. I would turn it around to a duty of fair representation, which the SEC is quite familiar with, and is applied to their regulated entities which ensures that the users, more broadly defined of the exchange. And maybe if you translated this into the clearinghouse, the users, but not necessarily the members of the clearinghouse, would have representation in terms of governance. I'm just saying, this is a different approach than having an ownership restriction, so people would be free to own the exchange singly or in groups -- or, excuse me, the clearinghouse -- but that there would be some duty of fair representation. ICE doesn't have that requirement at the moment, but they have

independent directors. I think, you know, that's a different idea than fair representation. Independent directors, to me, are most needed with public companies as under SOX when there was a broad duty to shareholders. But I think what's needed in this context is more the expert, and we heard before that it's very important that people that know what they're doing have input into those, and clearly major users of these clearinghouses, that is customers who clear through a member. Major hedge funds, for instance, have a lot of expertise, okay, in these areas, they're big traders, so, you know, I think we should think in terms of maybe that kind of requirement as opposed to an ownership restriction.

MS. SCHNABEL: Richard?

MR. PRAGER: My comments would support good governance. And when I say "governance," I am talking about governance with teeth. So as the soul fiduciary on this panel, we talk about membership, we talk about ownership, we believe

that very strong governance with the participation of the users of these venues is critically important. And as the fiduciary representing many clients and many types of clients -- and I think in the first panel we talked a lot about the financial resources of the members. And I think, Nancy, it was you who actually mentioned that the customer money, the margin, is the one that gets hit first. I think because we do get hit first -- I thought because we are the ones that are hit first, we have an absolutely vested interested in how well these things are -- these venues are run. So, you know, we would be in support of a very inclusive participation and governance with teeth.

MS. SCHNABEL: Lynn?

MS. MARTIN: I just wanted to respond to one of the items that was just recently discussed. We disagree with the fact that without -- with ownership limitations or without the imposition of ownership limitations, we are maintaining the status quo. If anything, bringing market participants into a more active dialogue with

exchanges, with clearing organizations, and with each other, benefits us as we move to central clearing and as we move these products to central clearing. Basically we are asking the market experts to opine on what structures work for them and we're asking them to help us solve these issues that caused or contributed to the financial crisis together in a collective manner as opposed to in silos.

MR. RADHAKRISHNAN: Before we go on to Michael, I'd also like the panel's views on ownership -- the ownership and governance structure of exchanges and SEFs. Because so far the discussion seems to be focused on clearing and that's not a bad thing, but, you know, there are also exchanges and SEFs, and if the panelists would address that, it would be much appreciated. Michael?

MR. GREENBERGER: Yeah, I think basically, you know, something that the CFTC should go back and look at is your 2007 rule. The result of that rule I'm not very crazy about, but

there was a lot of thinking that went into that that's applicable to this now. And one of the thoughts there -- that's the Chicago Mercantile Group's, which is an exchange and a clearing facility board of governance in a regulated market -- basically, you know, I think the vertical relationship between clearing and exchange trading is very, very strong, and so whatever we say here I think goes for both clearing and exchange trading. And I think as this market develops, it's going to develop like the regulated futures market where the clearing is not the big dog and the exchange following it, it'll be the exchange with clearing following it, as is true in the regulated markets.

I still -- if we want governance with teeth, governance with teeth will have ownership limitations. You can talk about fair representation, board governance, the fact of the matter is, and I think this will bear its way out in the comments to you, that does not protect fair and open access. The way fair and open access

will be maintained is I'm not saying that every bank cannot be part of the majority ownership, but the big swaps dealers who have an oligopic interest in the OTC market, 5 of them had 90 percent of the market, they've now set up their own exchange in effect. Some of them now want to set up their own individual clearing facilities, there will be lock outs there not because of capital that conforms to what traditional clearinghouses require, but capital requirements and other discriminatory rules that are excessive to the risk management function and shut people out. You can't compare OCC to a swaps clearing facility that is dominated by swaps dealers. I completely agree OCC, CME, the traditional clearinghouses, must have strong risk management, should have input from their members. They are a model, but their membership acceptance is not as restricted as what we are seeing with the swaps clearing facilities that are being brought about by the banks. And I think in those situations -- I shouldn't say banks, I should say swaps -- major

swaps dealers. In those situations, not every situation, ownership limitations should be imposed so they do not have majority control of the institution.

MS. SCHNABEL: Just to transition into the next topic, which is the board of directors, composition of the board of directors and composition of board committees, for those of you who do not support caps on voting, voting rights, or voting equity, how do you, I guess, think about the relationship between voting equity and the board of directors? Because ultimately the board of directors would be elected by the voting shareholders.

MR. SCOTT: I would just like to make a general point, maybe I should have been on the first panel to make this point, but -- I've been holding it in so I've got to get it out.

You know, it seems to me that there's one major regulator who has a big interest in this who's not at this table: It's the Federal Reserve.

MS. SCHNABEL: They're here in this room, by the way.

MR. SCOTT: Well, I'm glad. Maybe they should move to the table because, as you know, under Dodd-Frank, they have the power to declare clearing organizations as systemically important and thereby become their major regulator. Now, as we sit here, CFTC and SEC, adopting or thinking about conflict rules, these rules have a major impact on the systemic risk. And we've talked a lot about that in the first sessions of these (inaudible). So, it seems to me that this process needs to be coordinated. Now, this is another advertisement for a recommendation for committee that fell on deaf ears which was serious structural reform, but I would say that at the minimum, given where we are, you know, I hope that the Fed becomes a major party to this discussion.

MR. RADHAKRISHNAN: You should be aware that, you know, the SEC and us are in very close consultation with the Fed, but a couple of points, it's the FSOC, the Stability Oversight Council,

that makes the determination and we still remain the primary regulators. So, I think it's only when we are found to be deficient that the Fed gets defensive.

MR. SCOTT: Well, again, not an advertisement for structural reform, but, you know, if we don't get the regulatory structure right on this, we could make a lot of mistakes here. And all I'm saying is, yes, you are the functional regulator, but they are the party, if these institutions are designated as systemically important, who have overall responsibility for the systemic stability of our system. So you're going to have to work out amongst you how that happens.

MR. RADHAKRISHNAN: Here's a question on --

MR. SCOTT: I'm sorry. I apologize for this digression. I do think it's important that as we go forward on this conflicts issue we take this into account.

MR. RADHAKRISHNAN: So, to follow up on Nancy's question, the compositions of boards of

directors, not just at the clearinghouses, but also at DCMs themselves, should our two agencies mandate how that board should be composed? Should we impose a certain amount of independent directors? And please tell us how we should address boards of publically traded companies because I believe, you know, under the SEC rules there are different requirements if you happen to be a publically traded company, so should we defer to SEC rules of publically listed companies or should our rules be different assuming that we can get there?

MR. BARNUM: I'm going to take a shot at actually answering some of these questions as briefly as possible because we all have other things we want to say, too, so a couple things. One, I think it's clear that economic stakes are less risky and problematic than voting stakes. Does that mean that there's no appropriate regulatory oversight of those whatsoever? No, clearly not, but on the scale of things that I would worry if I were regulating this thing, I

would worry the least about non-voting economic stakes because those are the ones that are going to have the least impact on things like governance, strategy, innovation, membership, and all the things that directly feed into the policy objectives which are, in my opinion, primarily systemic risk and secondarily, you know, competition and maximum liquidity and access. So, I think that's the first thing.

Now, to go to the next question, if you then talk about composition of boards and public companies, the answer probably has to depend a little bit on, again, private versus public. So, private companies will have boards. Probably in private company boards that board will drift in more to some of the issues which might involve systemic risk, the public company board is going to be more constrained by traditional fiduciary responsibilities to the shareholders so realistically, I think the regulatory process is going to have to differentiate between those aspects of governance which speak directly to the

policy objectives of systemic risk and will probably have to have segregated boards for those types of decisions that are to some degree different from the boards that are in charge of the commercial objectives of the entity in question.

Unfortunately, I think what that means is that you wind up with kind of a wishy-washy answer, which is that it depends and it's case by case and it's going to be tedious and intensive rulemaking. But the alternative is to wind up with a very course tradeoff between the need to allow people to have commercial incentives to develop useful pieces of market infrastructure and insuring that once those things are developed, they don't create either anti-competitive patterns or excessive systemic risk.

MS. SCHNABEL: Jason?

MR. KASTNER: I've got several points that I'm going to make very quickly, but first I'm going to give a history lesson on the Federal Reserve system. We have a decentralized system

and there's a very good precedent and a good reason for decentralization and federalism and the same principles when they were crafting the Federal Reserve Act in 1913 apply today which is that you don't put all your eggs in one basket and you spread it around, and the best way to do that is to put ownership restrictions on SEFs, exchanges, DCOs, the idea is to diversify.

Now, this point about the status quo or not, it's -- if we allow risk to be concentrated in centrally cleared environments with the same three guys, five guys, it's worse than the status quo because now you've got all this stuff concentrated in a clearinghouse whereas before it was bilateral and there's all these ISDA agreements and everything's -- you know, at least maybe if the one thing fell over, it certainly wouldn't fall over, but I would say it's the status quo but worse.

Thirdly, this point about too small to survive, again, the problem is not when your small clearing member falls over, it's when the big

three guys -- so, as long as the clearinghouse is robust and diversified and decentralized, right, it's a robust system which addresses the issue of too big to fail.

MS. SCHNABEL: Richard?

MR. PRAGER: I think perhaps to answer Ananda's question, if you go back to Jeremy's example, if this was, in fact, a utility, a government-owned utility, and then you first ask yourself, now we're taking away the economic incentives, how would you want to govern that utility and what are the appropriate oversight boards or committees, whether they be a risk committee or a new product approval committee? So I think there's where perhaps the agencies should look at some sort of governance structure that should be followed with, you know, with all the prudence and risk management tools available run by the experts with a very inclusive participation of all of those who truly has their money at risk, which, of course, I would argue includes the buy side.

I think once that has been established then you can layer on the question in a public context of what -- whether it matters, if it's voting shares or non-voting shares, but at least you know you have a very solid structure that the agencies themselves would have oversight of.

MR. WORKIE: If I could just briefly go back to the ownership issue, should we be thinking differently about ownership with respect to individuals as opposed to groups? In other words, should we -- are there differences in the way we should be thinking about restrictions based on the cost of people as opposed to a certain person or certain individual can't own more than a certain percentage? Something like that.

MR. GREENBERGER: I think it's hard to answer that question because for example in the situation of Goldman, you don't know whether Goldman is bringing in other -- is Goldman going to be the only guarantor or are they going to bring other members in the organization? Certainly to the extent there's a one-member

clearinghouse you've got real problems on your hand in terms of you're putting all the risk in the hands of one institution, so I think you need to find out what these ideas are of single corporation clearinghouses and how they're going to work.

Getting back to the original question, again, and I think in 2004 to 2007 the CFTC thought these issues through very carefully. They originally proposed for exchanges, regulated exchanges, 50 percent independent boards of directors. My view would be no matter who owns -- there's a sliding scale here. If the ownership requirements are tough in terms of restrictions, then you would worry less about the board, but even with the toughest ownership restrictions, 50 percent -- I believe at least 50 percent of the board should be independent and I would -- I see my good friend Mark Young sitting over there -- I would adopt 80 percent of what the Futures Industry Association advocated with regard to the need for impendence on the board of the Chicago

Mercantile Group in that period. Their arguments for independence, how it's defined, look-back periods, are very, very strong. They were in the situation then of being Wall Street, being shut out of Chicago, and they advocated for open and fair markets and their arguments, I think, should carry the day for all exchanges.

MS. SCHNABEL: All right, only if you're very brief, Jeremy.

MR. BARNUM: I just wanted to say, look, again, unfortunately, there is a tension, there is a balancing act. Anyone who's been part of a risk management organization at a large bank knows that there is a risk of groupthink and so we know the focus here has got to be about risk committee. If the risk committee suffers from groupthink, then that creates systemic risk. That's bad. Independence is good. There should be as much independence as is possible on the risk committee. But there's another side to that which is that whether we like it or not, expertise in these markets is not broadly available and so you have

to have a balance between your desire for independence and the need to have expertise. And when you sacrifice independence in favor of expertise, it's important to remember that if you have non-independent people of expertise whose capital is at risk, then at least from the perspective of systemic risk -- I'm not speaking to open access independently of that -- but at least from the perspective of systemic risk, you could be reasonably assured that the incentives are aligned.

MR. RADHAKRISHNAN: We've got a few more questions that we need to ask. Jordan, go ahead.

MS. O'REGAN: Although Michael just answered this question, could other panelists discuss whether there is a certain percentage of independent directors or public directors that would alleviate the concerns we've been discussing.

MS. SCHNABEL: Okay, actually I'm going to take a vote if that's okay because that might be the easiest.

MR. RADHAKRISHNAN: And also the other issue is, what does independent mean?

MS. SCHNABEL: Okay, let's start with what does independence mean because then we can do the vote on percentages. Hal?

MR. SCOTT: Well, there's no one definition of independence. You can start with, you know, the New York Stock Exchange's definition. Numbers of exchanges have adopted definitions as (inaudible) and probably Sarbanes-Oxley. So basically -- but I would make the point that, you know, we don't necessarily need independence here, what we need is a non-membership point of view and expertise, the users of the system. You know, we need to ensure, if we're going to independent directors, they have expertise.

The most important thing is containing systemic risk and we need to make sure that the people who are participating in this understand it and know what it is. So I would not go -- I think we need independence on publically owned

companies, publically owned exchanges to protect the shareholders. But in non-publically owned institutions I would focus on the user's representation rather than independent directors which is a concept that we've mainly, to this point, applied to public companies.

MS. SCHNABEL: Michael?

MR. GREENBERGER: I again would go back to the Futures Industry Association comments. Their definition was no material relationship, but no relationship with the company. There was a one-year look back, they proposed a two-year look back. I think the look back could be even stronger. There was a limit to $100,000 in a service provider. If you had more than that you couldn't be a member. FIA said there should be no client-customer relationship and that it should extend to close relatives as well.

MS. SCHNABEL: Did you have something that you wanted to say?

MR. McVEY: Just a couple of things and we've touched on a number of topics, public versus

private and independence of directors and we have a little bit of experience with both having been a private company and now in the public arena. And I think that there are already significant obligations of independence on public companies, some of which serve as a good model, I think, for good governance structures that should apply to clearinghouses and SEFs and data warehouses and the like.

I personally think that one of the most important areas to focus on is the governance and nominating committee. How do people get on these boards? And if there is a requirement that that process be independent I think you would get both qualified people that are going to look after the best interest of the company, and you would get better independence on these boards.

The second requirement that I would look to is that most major industry groups should be represented on these boards. I don't think that there's a hard limit on the number of seats that can be held by any one constituent but certainly I

think when you look at the importance of these entities, the dealer community should be represented, the investment community should be represented, there should be quality risk management capabilities around that board, so I think broad industry representation should be a key principle as well.

I also think that to increase the level of duty and care among the directors on the entity itself, there should be a requirement that the directors are able to be compensated for their work. Some of them go into these jobs without being able to take compensation because they know there's a conflict of interest because they're there primarily to represent the interests of their own firm. So, I think if you would really look into the corporate and governance -- nominating process, you require industry representation from all groups and you require that directors are able to be compensated, we would have a better model.

MR. GREENBERGER: Can I make one quick

point? I wanted to make clear the $100,000 would not apply to compensation, that's in the -- in the rules they apply it, but as a director -- I don't put any limits on directors' compensation.

MS. SCHNABEL: Heather?

MS. SLAVKIN: I agree that the SEC has some good provisions in place with regard to public companies that provide for independence on the board. I think, though -- I agree also that governance and nominating committee independence is important, but I think one thing in addition that needs to be considered here is that there needs to be a real democratic process in place for actually electing the members of the board of directors. The current process for public companies where you could either vote for the board nominee or not vote for the board nominee, but can't actually vote against anybody or put up an opposing candidate doesn't result in a real democratic process and that causes some concerns.

I also want to go back to the issue that was raised before about ownership restrictions

versus voting caps. I actually disagree with what the gentleman from JP Morgan said when he said that he doesn't think that having an economic stake without having a voting interest is a concern. I think most of us can imagine a situation where someone owns 5 percent of our company and asks us to do something. I don't think it matters if that person gets to vote for the board of directors, that person has real influence regardless of whether it's formal influence, there is going to be influence over the decision making, there's going to be influence over the strategy and innovation and the trajectory of the institution in general, so I do think we need to look at ownership restrictions related to voting interests as well as related to economic interests even when they're not tied to actual voting shares.

MR. BARNUM: One sentence response. I didn't say it didn't matter at all, I said that on the scale of priorities, it would be at the bottom.

MR. BERNARDO: And I think as a SEF we can manage the conflicts of interest and the act doesn't require ownership limits but it does require compliance with the core principles and we need to have rules that are limiting that access.

MS. SCHNABEL: Okay. I actually have a very simplistic question. Given that independence, you know, has not yet been defined, I know that this is hard, but in terms of board of directors, 50 percent independent, who supports it, who doesn't? Sorry, raise hands.

MR. SCOTT: Of what are we talking about? Any entity? All entities?

MS. SCHNABEL: DCOs.

MR. SCOTT: Publically owned? Privately owned?

MS. SCHNABEL: Okay, clearing agencies, exchanges, swap execution facilities. Okay, let's start with privately owned.

Fifty percent, who's for it? I've got Michael. Anybody else? I've got Heather. Okay. Less than 50 percent, let's say 40 percent.

Anybody?

UNIDENTIFIED: Still private.

MS. SCHNABEL: Still private. Okay. Thirty percent?

MR. BARNUM: I would say 30 percent is desirable. It would be nice if you get it. If you mandate it, it could be a problem.

MS. SCHNABEL: Okay, and now public, 50 percent? All right, Hal, Michael, Heather. All right, now we're going to move on to committees. Lois, the next question?

MS. GREGORY: I have a question. In terms of board committees, what board committees are conflicts of interest most manifest on and how do we address that? With independence requirements? And if so, what percentage there?

MS. SCHNABEL: Okay, Hal.

MR. SCOTT: Again, I would not have -- I wouldn't answer this question any differently for the committee than I answered it for the organization as a whole, so if it's private, I would not insist on any independent directors on a

committee since I haven't insisted on it for the board as a whole. But I think narrowing in on the other aspect to your question as to what are the key committees we need to worry about, where I think the issue should be solved by representation of the users, not by independence requirements, would be the membership committee, the risk management committee, and probably the governance committee which would be, you know, if the organization had such a governance committee.

So, I think those would be three key committees where you would want to have representation from not just the members of the organization.

MS. SCHNABEL: So, let's talk about fair representation a little bit more. We recognize that's a question that's separate from independence. What -- I guess, at what threshold is representation fair? What should we look at to make sure that all market participants or all users have a say in the operation of a clearing agency or an exchange or a swap execution

facility?

MR. RADHAKRISHNAN: And then to add to that, how do we include them? For example, let's say you have an organization which says, I represent this group of people and I want to be represented, as opposed to a citizen of the street. Why should he or she not be included?

MR. SCOTT: I would address this, first of all, by not a one-size-fits-all approach. I think if you have a duty of fair representation you should allow each organization to come forward with a plan that in their view justifies or takes account of this fair representation. Different organizations may have different ways of doing this. I don't think we should set a magic number, but I think there should be a duty and, you know, so I guess that would be my answer.

MR. PRAGER: I think if you do -- I do think it is important to look at the participation. This is meant to address market reform and what's good for all the markets and healthy, stable financial markets. So, you know,

there is empirical evidence of who, in fact, is participating in these markets so I think there you can get a pretty good sense of the dealers, the investors, end users, corporations, and they need to have a seat at the table so I would be in favor of reserving certain seats at these respective committees. I'm probably a little bit less of the mind you have to be absolutely -- prescribe how many and in what committees, but there will be basic committees where you could have conflicts to your question before of what products can come on and, you know, there's this concern that there might be some perverse incentive not to have a product come on. Well, if the users are sitting there at those committees and saying, yes, please, we need that, it can be prudently managed, and you listen to some of the comments from the earlier panel about, you know, balancing those needs of what can be prudently risk- managed, and if it meets those criteria, I think that's where you get a very balanced view of what should be accepted as a clearable product or

not.

So, I do think that, you know, we're trying to serve the needs of the entire marketplace and, you know, each of those constituents should have a seat at these respective committees.

MS. SCHNABEL: Roger?

MR. LIDDEL: First of all, I think -- I don't think everybody can be represented but I think you can have, you know, individual organizations that are representative of a sector and that, I think, can be quite successful. Similarly, I don't think you need many truly, truly independent directors. A small number, I think, can keep a board honest.

And indeed I think this is an important time in our evolution, in the market evolution, and we're -- I mean, we're actively discussing now, internally, you know, bringing in different representations into our board potentially and onto some of our committees, you know, getting some significant buy side involvement, but frankly

that's not because of any views we've got on any conflict of interest, and that really rarely comes up at all, it's simply that we would actually benefit as an organization from having more input in expertise than a different sector of the market that is now becoming more important to us. So, that's the reason and motivation for doing it but it has the same end result, I think.

MR. BARNUM: I just wanted to expand briefly on what Mr. Prager said from Blackrock because I think that you raise a very useful point which is that one of the really big benefits, I think, of the legislation is the swap data repository requirement and that's going to mean that the regulatory community has a complete visibility over (inaudible) and that makes it quite easy to sort of monitor this and surveil it and sort of say, hey, wait a second, it appears that there's this community of people who's critical of this market. I can see it from the data, and they're not represented. And I think that's a very useful tool. In fact, in a number

of these policy issues, the increased visibility of both volumes and positions will, I think, enable this to be done much more fairly.

MR. GREENBERGER: I don't think fair representation can be viewed in isolation from the other issues. If you've got a small number of swaps dealers running a company I think you'll find that both the independent directors and the fair representers are going to fall short of the kind of concerns from the broker community that you've heard today. So, it's not an isolated situation. To the extent there is broader ownership and there will be the intermediaries who will want ownership, you're going to have a better board, whether it's independent or not, and better fair representation. I think somebody who's there for fair representation in an oligopic thing is really never going to be able to do their job and so I would just say that I think there's a relationship.

MR. SCOTT: Just one last point. I have to go early. There's another leg of this stool

here, this is the regulators. So, whatever these organizations do with respect to governance membership criteria or whatever, should be reviewed and reviewed in detail, okay, by the primary regulator. So, this is another protection of the system. So, you know, we heard from the first panel potential conflicts around things like how much capital you require of the member, do you -- nobody brought it up, but it's an issue, whether you accept a parent guaranty of a member in lieu of the member's own capital. Whether the member itself has the ability to resolve contracts in the extent of default, or could this be contracted out to a third party which have that capability. A number of these issues, and, you know, new products, whatever it is -- these rules should come to the regulator and the regulator should review these rules. So, another key part of the protection of the public here, an essential part, is not just the governance structure, but it's the regulatory structure that is looking over all of this. And so, Michael, I would say that --

you know, I think you would agree, whatever you do in ownership, we need a strong regulatory review function. In my view, that plus governance is enough, but others may and have disagree.

MR. RADHAKRISHNAN: So, while I think it's fair to say that the regulators represent the views of -- well, are here to make sure that the public interest is protected, do you think that there is a place for the American public, however you pick them, to be on the boards? Or is that completely unrealistic? Because all we've talked about is interest of market participants, but as, you know, Jason mentioned, one of the reasons why Congress went through this exercise is because the taxpayer footed an enormous bill. So, to make sure that the taxpayer doesn't do that again, is there a place for the average man or woman on the street to be represented, realizing that how you pick that man or woman on the street is going to be quite difficult?

MR. GREENBERGER: I think I'm going to give you a surprisingly conservative answer on

this. I do agree with what has been said, that you need experts on the board. What I disagree with is that all expertise comes from five swaps dealers or it all comes from people who work for banks. There are academics, former regulators, and, you know, other participants in the market who have talked today about their need for open and fair access. I think that kind of diversity on the board is important. I would worry very much about putting somebody on the board as a representative of the American public who isn't going to be able to abide by the fiduciary relationship to the institution, and these clearinghouses and exchanges and swaps execution facilities have a public -- I think that's what you're saying. Congress clearly sees them not as private, but having a public merit of stabilizing the economy, but I think to fulfill that you do have to have expertise on the board.

MR. PRAGER: Yeah, and I would agree that you need that expertise to really add value to the equation and if you do have, you know,

balanced participation, including fiduciaries like ourselves, we do represent the person on the street through their pension funds and other monies.

MR. BERNARDO: I just wanted to emphasize that the corporate governance core principles applicable to derivatives, clearing corps., and exchanges, is not applicable to SEFs.

MS. SLAVKIN: I think if the question is do we want regulators to pick a random person from the street and put them on the board of directors, that would be problematic. I think if you're talking in the context of a public company where the representative of the public would most likely be somebody who was selected by the shareholders, they would have to win an election and most of the votes in that election would be placed by institutional investors who are sophisticated, who understand the markets, who simply aren't going to vote for somebody who doesn't know what's going on, that doesn't have the sophistication and the expertise to make a significant contribution to

the board. And the people who are responsible for selecting that individual and running them as a candidate aren't going to put somebody up who doesn't have the expertise because oftentimes these are the same people that have an ownership interest and want to see the very company succeed. So, I do think there could be a place for an independent individual that's nominated by shareholders who have an economic interest in the financial stability and the success of the firm to, you know, have a seat on the board, but I don't think any random person off the street should have that position.

MS. SCHNABEL: Lynn.

MR. RADHAKRISHNAN: Lynn, yeah.

MS. MARTIN: I just wanted to respond to one item that was just brought up around the application of the core principles that apply to exchanges applying to swap execution facilities. I would actually argue that it's important for those same core principles that apply to DCMs and DCOs, particularly around conflicts of interests,

governance manners, and independence requirements potentially, so specifically core principles 15, 16, and 17, they actually provide a useful framework for mitigating these type of conflicts on the boards of exchanges and the boards of DCOs. So I think that we should think about potentially extending those core principles to apply not only to DCMs and DCOs, but to swap execution facilities as well.

MS. SCHNABEL: Okay, Jeremy.

MR. BARNUM: Sorry, just because I think that's actually a really important point because so far all the questions that I've been asked have sort of presumed that exchanges, SEFs and DCOs are sort of the same for the purposes of these governance issues and I actually think -- I believe that they're extremely different and that understanding those differences and getting it right is really critical. That doesn't mean that we're against, obviously, appropriate representation and governance on SEFs, but I think you have to look kind of at the scale and for me

the scale is the most critical, trickiest place where you have to balance systemic risk with other interests is the risk committee of the DCO. That's on one end of the continuum. On the other end of the continuum is the board of directors of a publically traded company where, you know, really, the real question is, these traditional questions that have obviously been heavily debated for years about how to manage that governance process (inaudible) shareholders, but it's pretty well removed from the micro functioning of the market as it relates to systemic risk. And I think SEFs, on that continuum, kind of lie in an interesting place. I've heard this is a controversial view but I think it's -- in my opinion, SEFs are not particularly important from a systemic risk perspective. I think SEFs serve a very important and relevant role in the legislation, but on the scale of things they don't do that much about systemic risk. Systemic risk is more happening in clearing and in post trade than happening in pre trade. There are other

policy objectives that are being served by SEFs.

MS. SCHNABEL: Okay, it's 12:00, so we're going to try to wrap up. So, I have one, I guess, thematic question. Just playing off of what Hal had been saying, and unfortunately he's not here to really defend himself, but it seems as if there is a three-legged stool that we've been all talking about and the first leg is ownership and voting; the second leg is board of directors and their composition and fair representation; and the third leg is objective criteria that regulators should be looking at and reviewing.

Of those three legs, which do you think are important or are they all important?

MR. BARNUM: They're all important and objective criteria is the most important.

MR. GREENBERGER: They're all important and ownership is the most important. It's the only -- Hal made the point that I can't argue with, that regulation is very important, but you as regulators -- because I was once in somewhat similar situation -- do not want to be on the

phone every day with people complaining about not having access, this, that, and the other thing. That's something you have to deal with up front to limit your regulatory responsibilities on the back end.

If you set this up so that an antitrust complaint or a phone call is the remedy, it's not going to work. This is one part -- the board governance or an ownership structure is one part of many powers you have. Don't let people talk you into the fact that, oh, you have these other powers, so don't worry about this. Because when you get to the other powers they'll be saying, oh, you had the board governance power, don't worry about this. They all have to go into effect at the same time.

The final point I would make, SEFs should not be treated any differently. It is well known that in the legislative process there was a big concern that SEFs were going to be a less regulatory environment to satisfy the need for exchange trading. You cannot let that happen. I

think the final legislation doesn't let that happen, and SEFs have to have the same governance process as everyone else.

MR. PRAGER: I think all three are very important. As I spoke earlier, I think the fair representation in governance is very important and I also think the regulation is important. These, certainly the DCOs, are the new too big to fails so they need to be monitored very carefully.

MR. LIDDEL: I think they are all necessary. I think they have different importance. I think that governance and regulation are the two most important legs. I think ownership is less important, frankly. I mean, our organization has had lots of changes in ownership structure over the years, small number of banks, huge number of financial institutions, exchanges, back and forth, and it's never, as far as I can tell, made any meaningful difference to how the company operates.

MS. MARTIN: I believe they're all important. Regulation is one of the most

important. We should look at what worked well during the financial crisis and those would be the exchanges, the centrally cleared markets, and we should take that into account when we're promulgating policies for swap execution facilities.

MR. KASTNER: I think they're all important but I would think that the most important question is, what does the customer want? What is good for the buy side customer? And we apply that with transparency, and we apply that by looking at different incentives. And the question, as you write the rule, should be, what is the incentive, really, behind this position or that position, and what is good for the customer first?

MR. McVEY: I think they are all important. I would put them in the order of, first, objective criteria around some of the key issues that have been discussed this morning in terms of which swaps are eligible for clearing which then triggers the exchange or SEF

requirement at the top of my list. I would put good governance and the board and decision-making process second and ownership third.

MR. BERNARDO: I think they're all important. I do think the objectiveness is possibly -- is probably the most important, but going back to the crisis, I don't think that the markets would have acted as efficiently as they did if it were not for the inter deal brokers who were the members of the WMBA.

MS. SLAVKIN: I think they're all equally important.

MR. RADHAKRISHNAN: All right. Well, thank you. This brings us to an end of this roundtable. We really appreciate the spirited discussion and the preparation that the panelists have shown.

I again will remind you of our invitation to send us comments at the Federal Register. Please send us your comments so that we can do thoughtful rulemaking.

Thank you so much.

(Whereupon, at 12:06 p.m., the PROCEEDINGS were adjourned.)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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